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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1935.

No. 350

NORTHWESTERN BELL TELEPHONE COMPANY,
APPELLANT,

vs.

NEBRASKA STATE RAILWAY COMMISSION

APPEAL FROM THE SUPREME COURT OF THE STATE OF NEBRASKA

FILED AUGUST 7, 1935.

SUPREME COURT OF THE UNITED STATES

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IN SUPREME COURT OF NEBRASKA

In the Matter of Depreciation Charges for Class "A" and Class "B" Telephone Companies

Re Northwestern Bell Telephone Company

General Order No. 59

Northwestern Bell Telephone Company, Appellant,

vs.

Nebraska State Railway Commission, Appellee

Præcipe—Filed July 3, 1934.

To the Clerk of the Supreme Court of Nebraska:

Please docket the enclosed transcript of record as an appeal from that certain order of the Nebraska State Railway Commission made and entered on the 9th day of April, 1934, as the same was amended by an order of said Commission made and entered on the 15th day of May, 1934, in a certain cause or proceeding before said Nebraska State Railway Commission initiated upon the motion of said Commission, wherein Northwestern Bell Telephone Company was respondent.

You will designate Northwestern Bell Telephone Company as appellant, and the Nebraska State Railway Commission as Appellee.

(Signed) F. E. Randall, (Signed) Tracy J. Peycke,
Attorneys for Appellant.

[File endorsement omitted.]

[fol. 6] [Caption omitted]

BEFORE NEBRASKA STATE RAILWAY COMMISSION

General Order No. 59

In the Matter of Depreciation Charges for Class "A" and Class "B" Telephone Companies

ORDER—Nov. 29, 1933

By BOLLEN, Commissioner:

The Interstate Commerce Act, by Section 1, provides that the provisions of the Act shall apply to common carriers engaged in the transmission of intelligence by wire or wireless between the states and with foreign nations. It further provides that the Act shall not apply to the transmission of intelligence by wire or wireless wholly within one state and not transmitted to or from a foreign country from or to any place in the United States as aforesaid.

By Section 20, the Act authorized the Interstate Commerce to require annual reports from all common carriers subject to the provisions of the act. Under this power, the Interstate Commerce Commission prescribed the Uniform System of Accounts for Telephone Companies, First Issue, effective January 1, 1913, as to Class "A" and Class "B" telephone companies. In the first issue of the Uniform System of Accounts for Telephone Companies, the Interstate Commerce Commission made depreciation accounting [fol. 7] mandatory, but it did not undertake to prescribe the rates of depreciation. The instructions pertaining thereto read in part as follows:

"The rate of depreciation should be fixed so as to distribute, as nearly as may be, evenly throughout the life of the depreciating property, the burden of repairs and the cost of capital consumed in operations during a given month or year, and should be based upon the average life of the units comprising the respective classes of property."

In 1920 the Interstate Commerce Act was amended, giving the Interstate Commerce Commission authority to prescribe the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged

with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. Paragraph 5 of Section 20 of the Interstate Commerce Act now reads in part as follows:

"The Commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this Act shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses."

In carrying out the purpose of the act as above amended, the Commission organized a Depreciation Section in its Bureau of Accounts and directed that section to make a preliminary investigation in the case of each class of carriers and to report its tentative conclusions and recommendations following this prelimnary investigation, that report to be used in each case as the basis for public hearings at which all interested parties would be given an opportunity to submit evidence in support of or in opposition to the recom- [fol. 8] mendations contained therein.

On March 10, 1923, the Telephone Depreciation Section submitted its report, and under Docket No. 14700 hearings were held commencing May 1, 1923, and continuing until October 22, 1928. On July 28, 1931, a final report was issued and a final order entered thereon. Depreciation accounting, as prescribed therein, was to become effective January 1, 1933. Preceding the effective date of the order, however, certain returns were to be filed by the telephone companies, as provided by paragraph 8 thereof, which reads as follows:

"*It is further ordered,* (8) That for the assistance of the Commission in prescribing the composite annual percentage rates to be effective beginning January 1, 1933, each operating Class A, Class B, and Class C telephone company subject to the act shall, not later than September 1, 1932, file with the state commission or commissions having jurisdiction over it, estimates of said percentage rates applicable to ledger values of the respective primary accounts covering the classes of property hereinbefore specified, owned and or used by such company; that such composite percentage rates shall be based upon estimated service values and service lives developed by a study of the company's history and experience and such engineering and other information as may be available with respect to future prospects, and shall produce a charge to operating expenses for the primary account, where more than one class of property is covered by the account, equal to the sum of the amounts that would otherwise be chargeable for each of the various classes; and that such estimates shall be accompanied by a sworn statement showing the bases therefor and the methods employed in their computation."

The effective date of the order has been twice postponed, so that as the order now stands, the latest date as of which the proposed percentage rates and supporting data are to be filed by Class A companies, with the state commissions or the Interstate Commerce Commission, is August 1, 1934, and the date as of which depreciation accounting prescribed therein becomes effective is January 1, 1935; all effective dates applicable to Class B companies are one year later than those applicable to Class A companies.

On November 12, 1932, the Interstate Commerce Commission adopted the "First Revised Issue" of Uniform System of Accounts for telephone companies, and included therein under general instructions, the provisions for de-
[fol. 9] preciation accounting as required by the order in Docket No. 14700. It became effective January 1, 1933, for Class A companies, and January 1, 1934, for Class B companies. The effective dates, as far as the "First Revised Issue" pertains to depreciation accounting has, by supplemental order of June 5, 1933, been extended to January 1, 1935, for Class A companies, and to January 1, 1936, for Class B companies.

The supplemental order of June 5, 1933, which extended the effective dates for filing proposed percentage rates and supporting data, and the effective dates for depreciation accounting, carried the following provision:

"*Provided*, That nothing in the foregoing shall be construed as relieving telephone companies from accounting for depreciation by the application to the primary plant accounts of composite annual percentage rates based upon the best estimates available of service lives and salvage values, as required by the Uniform System of Accounts for Telephone Companies, First Revised Issue."

For the year 1933, Classes A and B telephone companies will be required to account for depreciation to the Interstate Commerce Commission under the instructions contained in the above provision. For the year 1934 the Interstate Commerce Commission, through its Bureau of Accounts, issued its Depreciation Section Circular No. 7, which reads in part as follows:

"In order that the Commission may be informed as to the rates contemplated for use by the respective companies for the year 1934, each Class A and Class B telephone company is requested to submit not later than March 1, 1934, a schedule of the rates by primary accounts which it proposes to apply during that year, together with a statement of the estimated service lives and salvage values upon which such rates are based.

"In view of the fact that the estimated rates covered by the schedules to be submitted by Class A companies August 1, 1934, and by Class B companies August 1, 1935, must be accompanied by the necessary supporting data, and it is assumed that the preparation of these is receiving appropriate consideration at this time, the only requirement with respect to the rates submitted in response to this request is that the service lives and salvage values shown shall be based upon the best information readily available. In other words, for the purpose of the returns [fol. 10] to be made under this circular the details supporting the service lives and salvage values used will not be required."

There was attached to the above circular, certain forms to be used for depreciation percentages, for use during the

year 1934. These forms were sent and are now in the possession of all Class A and Class B telephone companies to be used by them in filing with the State Commission on or before March 1, 1934, the depreciation percentages and available supporting data.

This Commission has never considered or attempted to fix depreciation charges for Class A and Class B telephone companies, except when such charges were involved in a pending rate case. In view of the powers granted to the Interstate Commerce Commission by Paragraph 5 of Section 20 of the Interstate Commerce Act, and the section already taken by the Interstate Commerce Commission pursuant thereto under Docket No. 14700, and supplemental orders thereon, it now becomes imperative that this Commission consider the matter of depreciation charges for accounting purposes to this Commission.

Jurisdiction

We are first confronted with the question of jurisdiction. We should say in the beginning that the Interstate Commerce Commission is not responsible for its jurisdiction to fix the rates of depreciation of telephone companies. It was thrust upon that body by Congress, and the Interstate Commerce Commission should receive the highest commendation from all state commissions for the progress already made. If, however, it was the intention of Congress to authorize the Interstate Commerce Commission to fix depreciation rates for the purpose of uniform accounting to the Interstate Commerce Commission, then this Commission has no objection. On the other hand, if it was the intention of Congress to authorize the Interstate Commerce Commission to fix depreciation rates for the purpose of [fol. 11] accounting to the state regulatory bodies, then this Commission should and must object.

The amount allowed in operating expenses for accrued depreciation is a factor in determining the rate for telephone service, and cases will arise where an excess of 1% allowed for depreciation will amount to an excess of 1% over a reasonable return. Congress has not delegated to the Interstate Commerce Commission any regulatory power over rates of telephone companies. On the other hand, this Commission, under the Constitution and the Stat-

utes of Nebraska, has been delegated the regulatory power to fix reasonable rates for intrastate telephone service.

Section 1 of the Interstate Commerce Act applies to all common carriers engaged in interstate telephone service; it does not apply to common carriers engaged in intrastate telephone service. Paragraph 1 of Section 20 of the Act authorized the Interstate Commerce Commission to require annual reports from all common carriers subject to the provisions of the Act. Under this power the Interstate Commerce Commission, in 1913, set up a uniform system of accounts for telephone companies, and required annual reports. This Commission has not set up an accounting system for Class A and Class B telephone companies, but has allowed such companies to file with this Commission a copy of the reports filed with the Interstate Commerce Commission. Up to this point, it was clearly the intention of Congress to establish uniformity in accounting and reporting to aid State Commissions in their regulatory powers, and to be used by the State Commission if they so desired.

Section 20, Paragraph 5 of the Act as amended, now provides that the Interstate Commerce Commission shall prescribe percentages of depreciation which shall be charged [fol. 12] with respect to each class of telephone property. In conformity with this amendment, the Interstate Commerce Commission has made its investigation and held many hearings, all of which has resulted in the findings and order in Docket No. 14700. It has incorporated this order in the "First Revised Issue" of Uniform System of Accounts for telephone companies. The effective date for filing with the State Commissions, depreciation percentages and supporting data, for Class A companies has been extended to August 1, 1934, and for Class B companies to August 1, 1935. To establish percentage rates for 1934, Circular No. 7 provides that percentage rates and certain available data must be filed with the State Commissions on or before March 1, 1934. In view of the fact that nearly all telephone service is intrastate, and the further fact that the State Commissions have regulatory power to fix reasonable rates for service, it is our opinion and we so find that Congress did not intend to authorize the Interstate Commerce Commission to prescribe depreciation rates, except for the sole purpose of establishing uniformity in depreciation accounting to the Interstate Commerce Commission,

and for the purpose of aiding the State Commissions in fixing a depreciation rate. In other words, the Interstate Commerce Commission has the final word on depreciation accounting for the purpose of a uniform system of accounting to the Interstate Commerce Commission, and the State Commissions have the final word in fixing depreciation percentages as far as its accounting and reporting systems are concerned. It was clearly not the intention of Congress to deprive the State Commissions of their regulatory power to fix reasonable telephone rates.

Cooperation

Congress has been liberal in its appropriation to support the activities of the Interstate Commerce Commission, and [fol. 13] as a result, the Interstate Commerce Commission has established a Depreciation Section in its Bureau of Accounts, with a staff and facilities that no state commission would be able to support. Docket No. 14700 is a master study of depreciation accounting, and the principles there enunciated should be adopted by this Commission as a basis for depreciation accounting. This Commission should avail itself of the studies and progress already made by the Interstate Commerce Commission, and cooperate with it to the end that the account representing reserve for accrued depreciation may reflect, as nearly as possible, the actual depreciation of the combined classes of depreciable telephone property. An order should be entered directing all Class A and Class B telephone companies to file with this Commission, as soon as possible, and not later than March 1, 1934, the depreciation percentages they propose to use for 1934, with such available supporting data as is required by Schedules 1 and 2 attached to Depreciation Section Series Circular No. 7. Another order should be entered directing all Class A telephone companies to file with this Commission, not later than August 1, 1934, their proposed depreciation rates for the year 1935, as required by the Interstate Commerce Commission in Docket No. 14700, and all supplemental orders pertaining thereto. A like order should be entered for all Class B telephone companies, except as to the respective dates.

Procedure

The Commission is of the opinion and so finds that the procedure adopted by the Interstate Commerce Commission, for prescribing depreciation rates, should be adopted by this Commission, except that when the Interstate Commerce Commission shall have prescribed the rate of depreciation after hearings by this Commission and the recommendations of this Commission thereon, the said rate [fol. 14] should not be final, as far as accounting to this Commission is concerned, but subject to review by this Commission and a final order entered thereon.

Order

It is therefore ordered by the Nebraska State Railway Commission:

1. That all Class A and Class B telephone companies be and they hereby are ordered to file with this Commission not later than March 1, 1934, a schedule of depreciation rates by primary accounts, which they propose to apply for the year 1934, together with such supporting data as is required by the Interstate Commerce Commission in Schedules 1 and 2 attached to Circular 7, Depreciation Section Series.

2. That all Class A telephone Companies file with this Commission, not later than August 1, 1934, their composite annual percentage rates to be effective January 1, 1935, and in accordance with Paragraph 8 of the order in Docket No. 14700, and all supplemental orders that have been or may be entered thereon.

3. That all Class B telephone companies file with this Commission, not later than August 1, 1935, their composite annual percentage rates to be effective January 1, 1936, and in accordance with Paragraph 8 of the order in Docket No. 14700, and all supplemental orders that have been or may be entered thereon.

4. That the procedure adopted by the Interstate Commerce Commission for prescribing depreciation rates be and the same is hereby approved, except that this Commission reserves the right to review the findings and conclusions of the Interstate Commerce Commission and enter a

final order thereon as to the depreciation rate for accounting purposes to this Commission.

[fol. 15] Made and entered at Lincoln, Nebraska, this 29th day of November, 1933.

Nebraska State Railway Commission, (Signed) C. A. Randall, Chairman. (Seal.)

Attest: (Signed) J. F. Miller, Secretary.

Commissioners concurring: (Signed) F. L. Bollen. (Signed) Hugh Drake.

[fol. 16] Before Nebraska State Railway Commission

SCHEDULE FILED FEB. 28, 1934

Schedule 1—Sheet 1

Northwestern Bell Telephone Company

Schedule of Property Included in Telephone Plant Accounts as of January 1 1934 and Depreciation Percentages for Use During the Year 1934

Primary Accounts Covering Depreciable Property		Ledger Value January 1, 1934)	Depreciation Rates	Estimated Annual Depreciation Charge (See Note Below)
No.	Title			
(1)		(2)	(3)#	(4)
207	Right of Way	$541,257.02	2.6	$14,073
212	Buildings	14,195,831.42	2.6	369,092
221	Central Office Equipment	28,303,125.75	5.2	1,471,763
231	Station Apparatus	8,841,150.73	6.4	565,834
234	Private Branch Exchanges	2,261,157.54	7.0	158,281
235	Booths and Special Fittings	438,586.17	6.9	30,262
241	Pole Lines	20,784,758.90	5.0	1,039,238
242	Cable	23,410,852.25	3.6	842,791
243	Aerial Wire	13,295,699.36	3.6	478,645
244	Underground Conduit	6,352,775.89	2.0	127,056
261	Furniture and Office Equip	1,257,225.92	6.9	86,749
264	Vehicles and Other Work Equipment	1,371,687.13	17.8	244,160
	Total—Depreciable Accounts	121,054,108.08	....	5,427,944

Estimated annual composite rate of depreciation for all depreciable accounts—determined by dividing the total estimated depreciation charges shown in column (4) by the total ledger value of all depreciable accounts shown in column (2) 4.48%

Note: The amounts shown in column (4) were determined by multiplying the amounts in column (2) by the rates shown in column (3). The actual charges for the year will be more or less than the amounts shown in column (4) depending on the fluctuation in the plant account during the year.

Based on composition of plant in each primary account Jan. 1, 1934.

[fol. 17] Schedule 1—Sheet 2

Northwestern Bell Telephone Company

Schedule of Property Included in Telephone Plant Accounts as of January 1, 1934
Depreciation Percentages for Use During the Year 1934

No.	Primary Accounts Covering Non-depreciable Property (1) Title	Ledger Value (January 1, 1934) (2)
201	Organization	$133,535.25
202	Franchises	.....
203	Patent rights	.....
211	Land	1,604,677.01
232	Station installations	3,798,965.89
233	Drop and block wires	3,147,964.64
276	Telephone plant purchased	.....
277	Telephone plant sold	.....
278	Undistributed cost of property	479,395.39
280	Construction work in progress	391,372.09
	Total Non-depreciable accounts	9,555,910.27
	Total ledger value—All plant accounts	130,610,018.35

Estimated annual composite rate of depreciation for all plant accounts—determined by dividing the total estimated depreciation charges shown in column (4) sheet 1 by the total ledger value of all plant accounts shown in column (2) above 4.16%

[fol. 18] Schedule 2—Sheet 1

Northwestern Bell Telephone Company

Computation of Composite Rates for Primary Accounts as of January 1, 1934

Primary Account 207 Right of Way

Kind of Property (1)	Ledger Value (Amount) (2)	Service Life (Years) (3)	Net Salvage Value (%) (4)	Annual Percentage Rates (5)	Estimated Annual Depreciation Charge (Amount) (6)
Exchange	$72,854	30	0	3.3	$2,404
Toll	468,403	40	0	2.5	11,710
Totals	541,257	....	....	....	14,114

Total investment included in account	$541,257
Estimated annual depreciation charge	14,114
Annual composite rate of percentage of depreciation applicable to total of primary account	2.6%

Schedule 2—Sheet 2

Northwestern Bell Telephone Company

Computation of Composite Rates for Primary Accounts as of January 1, 1934

Primary Account 212 — Buildings

Kind of Property	Ledger Value (Amount)	Service Life (Years)	Net Salvage Value (%)	Annual Percentage Rates	Estimated Annual Depreciation Charge (Amount)
(1)	(2)	(3)	(4)	(5)	(6)
Large Dial	$10,224,514	44	3	2.2	$224,939
No. 1 Manual	3,346,621	27	10	3.3	110,438
Small Manual or Dial	604,384	22	10	4.1	24,780
Total Buildings—Other	14,175,519	....	....	....	360,157
Improvements to Leased Bldgs.	20,312	....	....	....	4,308
Totals	14,195,831	....	....	....	364,465

Total investment included in account	$14,195,831
Estimated annual depreciation charge	364,465
Annual composite rate or percentage of depreciation applicable to total of primary account	2.6%

[fol. 19]

Schedule 2—Sheet 3

Northwestern Bell Telephone Company

Computation of Composite Rates for Primary Accounts as of January 1, 1934

Primary Account 221 — Central Office Equipment

Kind of Property	Ledger Value (Amount)	Service Life (Years)	Net Salvage Value (%)	Annual Percentage Rates	Estimated Annual Depreciation Charge (Amount)
(1)	(2)	(3)	(4)	(5)	(6)
Nos. 1, 3, and 11	$7,811,941	16	5	5.9	$460,905
Other C. B. Manual	1,629,327	17	5	5.6	91,242
Magneto	613,566	20	5	4.8	29,451
Total Manual—Other	$10,054,834	....	....	5.8	$581,598
Manual—Miscellaneous Portable Equipment	125,361	6	25	12.5	15,670
Manual—Toll Terminal & Telegraph Eqpt.	3,226,737	12	10	7.5	242,005
Total Manual	$13,406,932	....	....	6.2	$839,273
Total Dial	14,896,194	22	5	4.3	640,536
Grand Total	$28,303,126	....	....	....	$1,479,809

Total investment included in account	$28,303,126
Estimated annual depreciation charge	1,479,809
Annual composite rate or percentage of depreciation applicable to total of primary account	5.2%

Schedule 2—Sheet 4

Northwestern Bell Telephone Company

Computation of Composite Rates for Primary Accounts as of January 1, 1934

Primary Account 231 — Station Apparatus

Kind of Property	Ledger Value (Amount)	Service Life (Years)	Net Salvage Value (%)	Annual Percentage Rates	Estimated Annual Depreciation Charge (Amount)
(1)	(2)	(3)	(4)	(5)	(6)
Station Apparatus.....	$8,841,151	5.5	65	6.4	$565,834

Total investment included in account.....	$8,841,151
Estimated annual depreciation charge.....	565,834
Annual composite rate or percentage of depreciation applicable to total of primary account.....	6.4%

[fol. 20]

Schedule 2—Sheet 5

Northwestern Bell Telephone Company

Computation of Composite Rates for Primary Account as of January 1, 1934

Primary Account 234 — Private Branch Exchanges

Kind of Property	Ledger Value (Amount)	Service Life (Years)	Net Salvage Value (%)	Annual Percentage Rates	Estimated Annual Depreciation Charge (Amount)
(1)	(2)	(3)	(4)	(5)	(6)
Other Systems.....	$1,424,947	9	45	6.1	$86,922
Special systems.....	836,211	9.5	20	8.4	70,242
Totals.....	$2,261,158	....	....	....	$157,164

Total investment included in account.....	$2,261,158
Estimated annual depreciation charge.....	157,164
Annual composite rate or percentage of depreciation applicable to total of primary account.....	7.0%

Schedule 2—Sheet 6

Northwestern Bell Telephone Company

Computation of Composite Rates for Primary Accounts as of January 1, 1934

Primary Account 235 — Booths and Special Fittings

Kind of Property	Ledger Value (Amount)	Service Life (Years)	Net Salvage Value (%)	Annual Percentage Rates	Estimated Annual Depreciation Charge (Amount)
(1)	(2)	(3)	(4)	(5)	(6)
Booths and Special Fittings.....	$438,586	8	45	6.9	$30,262

Total investment included in account.....	$438,586
Estimated annual depreciation charge.....	30,262
Annual composite rate or percentage of depreciation applicable to total of primary account.....	6.9%

[fol. 21] Schedule 2—Sheet 7

Northwestern Bell Telephone Company

Computation of Composite Rates for Primary Accounts as of January 1, 1934

Primary Account No. 241 Pole Lines

Kind of Property	Ledger Value (Amount)	Service Life (Years)	Net Salvage Value (%)	Annual Percentage Rates	Estimated Annual Depreciation Charge (Amount)
(1)	(2)	(3)	(4)	(5)	(6)
Exchange--					
Town Treated	$3,410,244*	23	− 7	4.7	$160,281
Town Untreated	1,702,950*	15	− 8	7.2	122,612
Rural Treated	1,136,748*	26	− 7	4.1	46,607
Town Untreated	1,702,950*	19	−14	6.0	102,177
Crossarms	527,860*	20	− 7	5.4	28,504
Total Exchange	$8,480,752	....	....	5.4	$460,181
Toll—Min. & No. Dak.—					
Treated	$2,079,082*	26	− 5	4.8	83,163
Untreated	1,132,254*	19	−11	5.8	65,671
Crossarms	1,053,408*	20	− 5	5.3	55,831
Total	$4,264,744	....	....	4.8	$204,665
Toll—Iowa & Neb.-S. D.—					
Treated	$4,781,697*	24	0	4.2	$200,831
Untreated	1,320,375*	17	− 4	6.1	80,543
Crossarms	1,937,191*	20	0	5.0	96,860
Total	$8,039,263	....	....	4.7	$378,234
Total Toll	$12,304,007	....	....	....	$582,899
Totals	$20,784,759	....	....	....	$1,043,080
Total investment included in account					$20,784,759
Estimated annual depreciation charge					1,043,080
Annual composite rate or percentage of depreciation applicable to total of primary account					5.0%

* Estimated.

[fol. 22] Schedule 2—Sheet 8

Northwestern Bell Telephone Company

Computation of Composite Rates for Primary Accounts as of January 1, 1934

Primary Account 242 — Cable

King of Property	Ledger Value (Amount)	Service Life (Years)	Net Salvage Value (%)	Annual Percentage Rates	Estimated Annual Depreciation Charge (Amount—
(1)	(2)	(3)	(4)	(5)	(6)
Exchange Aerial	$9,237,173*	22	7	4.2	$387,961
Toll Aerial Entrance	436,292*	22	7	4.2	18,324
Toll Aerial Intercity	521,151*	30	7	3.1	16,156
Total Toll Aerial	957,443			3.6	34,480
Exchange Underground—Main	9,163,982	32	21	2.5	229,100
Exchange Underground—Subsidiary	2,981,106	20	0	5.0	149,055
Toll Underground—Entrance	679,566*	25	21	3.2	21,746
Toll Underground—Intercity	344,361*	30	0	3.3	11,364
Total Toll Underground	$1,023,927	....	....	3.2	$33,110
Submarine	47,221	15	0	6.7	3,164
Totals	$23,410,852	....	....	....	$836,870

Total investment included in account $23,410,852
Estimated annual depreciation charge 836,870
Annual composite rate or percentage of depreciation applicable to total of primary account 3.6%

* Estimated.

[fol. 23] Schedule 2—Sheet 9

Northwestern Bell Telephone Company

Computation of Composite Rates for Primary Accounts as of January 1, 1934

Primary Account 243 — Aerial Wire

Kind of Property	Ledger Value (Amount)	Service Life (Years)	Net Salvage Value (%)	Annual Percentage Rates	Estimated Annual Depreciation Charge (Amount)
(1)	(2)	(3)	(4)	(5)	(6)
Exchange	$1,977,478	20	−12	5.6	$110,739
Toll—					
Copper	10,572,715*	25	28	3.0#	317,181
Iron	745,506*	18	−15	4.5#	48,458
Total Toll	$11,318,221	....	....	3.2#	365,639
Totals	$13,295,699	....	....	....	$476,378

Total investment included in account $13,295,699
Estimated annual depreciation charge 476,378
Annual composite rate or percentage of depreciation applicable to total of primary account 3.6%

* Estimated.

This rate includes 0.1% as a provision for temporary facilities.

Schedule 2—Sheet 10

Northwestern Bell Telephone Company

Computation of Composite Rates for Primary Accounts as of January 1, 1934

Primary Account 244 — Underground Conduit

King of Property	Ledger Value (Amount)	Service Life (Years)	Net Salvage Value (%)	Annual Percentage Rates	Estimated Annual Depreciation Charge (Amount—
(1)	(2)	(3)	(4)	(5)	(6)
Main	$5,077,419	60	0	1.7	$86,316
Subsidiary	1,275,357	30	0	3.3	42,086
Total	$6,352,776	....	....	....	$128,402

Total investment included in account	$6,352,776
Estimated annual depreciation charge	128,402
Annual composite rate or percentage of depreciation applicable to total of primary account	2.0%

Schedule 2—Sheet 11

Northwestern Bell Telephone Company

Computation of Composite Rates for Primary Accounts as of January 1, 1934

Primary Account 261 — Furniture and Office Equip.

Kind of Property (1)	Ledger Value (Amount) (2)	Service Life (Years) (3)	Net Salvage Value (%) (4)	Annual Percentage Rates (5)	Estimated Annual Depreciation Charge (Amount) (6)
Furniture and Office Equipment	$1,257,226	13	10	6.9	$86,749

Total investment included in account	$1,257,226
Estimated annual depreciation charge	86,749
Annual composite rate or percentage of depreciation applicable to total of primary account	6.9%

[fol. 24] Schedule 2—Sheet 12

Northwestern Bell Telephone Company

Computation of Composite Rates for Primary Accounts as of January 1, 1934

Primary Account 264 Vehicles and Other Work Equipment

Kind of Property (1)	Ledger Value (Amount) (2)	Service Life (Years) (3)	Net Salvage Value (%) (4)	Annual Percentage Rates (5)	Estimated Annual Depreciation Charge (Amount) (6)
Motor Vehicles, Passen-Cars & Ford Trucks	$636,675*	4	10	22.5	$143,252
Light Trucks	83,361*	5	10	18.0	15,005
Heavy Construction Trucks	247,887*	9	10	10.0	24,789
Total	$967,923	....	....		$183,046
Garage & Motor Vehicle Shop Equipment	15,762	10	0	10	1;576
Special Tools and Work Equipment	26,617	5	5	19	5,057
Other Shop Equipment	.....	....	....	....	.....
Other Tools and Work Equipment	361,385	4	40	15	54,208
Total	$1,371,687	....	....	....	$243,887

Total investment included in account	$1,371,687
Estimated annual depreciation charge	243,887
Annual composite rate or percentage of depreciation applicable to total of primary account	17.8%

* Estimated.

[fol. 25] Before Nebraska State Railway Commission

General Order No. 59

Order Fixing Time of Hearing for The Northwestern Bell Telephone Co.—March 6, 1934

In the Matter of Depreciation Charges for Class "A" and Class "B" Telephone Companies

By the Commission:

Pursuant to our order of November 29th, 1933, the Northwestern Bell Telephone Company has filed with the Commission its schedule of depreciation rates by primary accounts which it proposes to apply for the year 1934, together with the supporting data as required by the Interstate Commerce Commission in Schedules 1 and 2 of Circular 7, Depreciation Section Series, and the same having

been examined by our Engineering staff and not being fully satisfied with the rates proposed, we find that the cause should be set down for hearing for oral examination of the members of respondent's staff, who prepared said schedules, and for the introduction of such evidence the Commission may desire to submit with opportunity of objections and cross-examination by respondent.

It is therefore ordered that the cause be set down for hearing on the 19th day of March, 1934, at the hour of 10 o'clock a. m. at the Commission's hearing room in the state capitol.

Made and entered at Lincoln, Nebraska, this 6th day of March, 1934.

Nebraska State Railway Commission, (Signed) C. A. Randall, Chairman. (Seal.)

Attest: (Signed) J. F. Miller, Secretary.

Commissioners Concurring: (Signed) F. L. Bollen. (Signed) Hugh Drake.

[fol. 26] BEFORE NEBRASKA STATE RAILWAY COMMISSION

MINUTE ENTRIES

The following entry was made in the Secretary's record on March 6th, 1934, in connection with the above order:

Lincoln, Nebraska, March 6, 1934.

The Commission met in regular session Tuesday, March 6, with all members present.

* * * * * * *

Commissioner Bollen presented orders fixing the time of hearing under General Order No. 59 for the Lincoln Telephone & Telegraph Company and the Northwestern Bell Telephone Company, and said orders were concurred in, fixing such hearings at 10:00 o'clock a. m. on March 21, and 19, respectively.

* * * * * * *

And afterwards, to-wit: On the 19th day of March, 1934, the following entry was made in the records of the Commission, to-wit:

Lincoln, Nebraska, March 19, 1934.

Pursuant to notice previously given all members of the Commission held a hearing on General Order No. 59, in the hearing room of the Commission at 10 o'clock a. m.

Testimony was taken. At 5 o'clock the hearing was adjourned to the following morning at 10 o'clock.

* * * * * * *

And afterwards, to-wit: On the 20th day of March, 1934, the following entry was made in the records of the Commission, to-wit:

Lincoln, Nebraska, March 20, 1934.

Pursuant to adjournment on the preceding day, all members of the Commission continued the hearing on General Order No. 59, in the hearing room of the Commission at 10 o'clock a. m.

Testimony was taken and the matter submitted on the record.

* * * * * * *

[fol. 27] BEFORE NEBRASKA STATE RAILWAY COMMISSION

General Order No. 59

In the Matter of Depreciation Charges for Class "A" and Class "B" Telephone Companies

Re NORTHWESTERN BELL TELEPHONE CO.

OPINION, FINDINGS, CONCLUSIONS AND ORDER—April 9, 1934

BOLLEN, Commissioner:

Our General Order No. 59 directed all Class "A" and Class "B" Telephone companies to file with the Commission not later than March 1, 1934, a schedule of depreciation rates by primary accounts which they proposed to apply for the year 1934, together with such supporting data as is required by the Interstate Commerce Commission in Schedules 1 and 2 attached to Circular 7 Depreciation Sec-

tion Series. Pursuant thereto the Northwestern Bell Telephone Company filed its proposed rates for 1934 on depreciable property by primary accounts. It did not segregate its Nebraska properties from its total properties in the five states. The proposed rates for 1934 are as follows:

"Schedule of Property

Included in Telephone Plant Accounts as of January 1, 1934

and

Depreciation Percentages for Use During the Year 1934

Primary Accounts Covering Depreciable Property No.	Title	Ledger Value (January 1 1934)	Depreciation Rates	Estimated Annual Depreciation Charge (See Note Below)
	(1)	(2)	(3)	(4)
207	Right of Way	$541,257.02	2.6	$14,073
212	Buildings	14,195,831.42	2.6	369,092
221	Central Office Equipment	28,303,125.75	5.2	1,471,763
231	Station Apparatus	8,841,150.73	6.4	565,834
234	Private Branch Exchanges	2,261,157.54	7.0	158,281
235	Booths and Special Fittings	438,586.17	6.9	30,262
[fol. 28]				
241	Pole Lines	20,784,758.90	5.0	1,039,238
242	Cable	23,410,852.25	3.6	842,791
243	Aerial Wire	13,295,699.36	3.6	478,645
244	Underground Conduit	6,352,775.89	2.0	127,056
261	Furniture & Office Equipment	1,257,225.92	6.9	86,749
264	Vehicles and Other Work Equipment	1,371,687.13	17.8	244,160
	Total—Depreciable Accounts	$121,054,108.08	....	$5,427,944

Estimated annual composite rate of depreciation for all depreciable accounts—determined by dividing the total estimated depreciation charges shown in column (4) by the total ledger value of all depreciable accounts shown in column (2).....4.48%"

The Commission not being satisfied with the rates proposed set the matter down for hearing for oral examination of the respondent's staff who prepared the schedules and supporting data, and for submission of further evidence by the Commission with opportunity for cross-examination by the respondent. The matter came on for hearing before the full Commission on March 19, 1934. After two days of hearing the matter was submitted and taken under advisement. Page 2 of Exhibit 3 submitted by the Commission shows respondent's plant investment, except right of way, depreciation reserve, ratio to plant investment and annual composite depreciation rates from January 1, 1921, to December 31, 1932, as follows:

"Date	Plant & Equipment	Reserve for Accrued Depreciation	Ratio of Reserve to Investment	Average Annual Rate of Reserve
Jan. 1, 1921...	$70,284,135.22	$12,065,014.19	%17.17	%....
Dec. 31, 1921...	74,118,690.38	14,222,661.93	19.19	5.11
Dec. 31, 1922...	75,884,410.69	15,883,754.45	20.93	5.06
Dec. 31, 1923...	78,348,568.42	18,487,100.90	23.60	5.20
Dec. 31, 1924...	83,249,357.52	21,244,493.11	25.52	5.19
Dec. 31, 1925...	85,499,159.99	23,129,346.76	27.05	5.20
Dec. 31, 1926...	88,226,588.84	24,925,328.21	28.25	5.19
Dec. 31, 1927...	95,753,568.28	26,553,569.77	27.73	5.11
Dec. 31, 1928...	100,211,581.30	26,609,605.89	26.55	5.09
Dec. 31, 1929...	111,880,273.58	28,331,071.27	25.32	4.97
Dec. 31, 1930...	119,514,676.63	29,096,295.71	24.35	4.89
Dec. 31, 1931...	123,610,927.53	29,176,457.30	23.60	4.91
Dec. 31, 1932...	126,962,097.18	30,774,818.09	24.24	4.67"

[fol. 29] Exhibit 4 submitted by the Commission is an exhibit submitted by the respondent in 1933, in Resolution No. 128, in the Matter of Reduction of Telephone Rates for Rural and Switched Subscribers of the Northwestern Bell Telephone Company, on the Commission's own motion. It shows an estimated 88 per cent condition of its Nebraska plant investment. Exhibit 3 shows that its reserve for accrued depreciation of December 31, 1932, was 24.24 per cent of its plant investment. This would indicate that the respondent is now carrying an excess of 12 per cent in its depreciation reserve account more than the actual depreciation or per cent condition of its plant investment. Respondent stoutly maintains there is no relationship between actual depreciation and reserve for accrued depreciation. We are unable to agree. There may be and are cases where an insufficient amount has been collected for accrued depreciation and in such cases reserve for accrued depreciation does not reflect the actual depreciation. There are other cases and we believe that this is one of them, where too much has been collected for accrued and accruing depreciation and the reserve for accrued and accruing depreciation does not reflect the actual or percent condition of the plant investment. The difference between respondent's reserve for accrued depreciation and its estimated actual depreciation indicate that there has not been proper cooperation between its plant engineers and its valuation engineers. Plant engineers determine the amount required from current revenue to keep the company's investment intact. Valuation engineers determine the amount to be deducted from plant investment for the purpose of fixing a fair value upon which to base rates. The results to be obtained is

just the opposite of the results to be obtained by the other. It appears to be the policy of utility companies not to let the right hand know what the left hand doeth.

[fol. 30] In the case of Smith v. Illinois Bell Telephone Co. (1930) 282 U. S. 133, 75 L. Ed. 255, 256, P. U. R. 1931 A, 1, 12, 51 S. Ct. 65, it was held:

"The allowance for depreciation entering into the ascertainment of the rate base of a public utility may be based on past experience, and should not be continued if shown by such experience to be excessive.

"Results shown under comparable conditions by other utility companies similarly situated, together with past experiences of the company in question, should afford a sound basis for judgment as to the amount which should be allowed as an annual charge for depreciation in fixing a rate base."

In the opinion in said case the court further says:

"While it has been held by this court that property paid for out of moneys received for past services belongs to the company, and that the property represented by the credit balance in the reserve for depreciation cannot be used to support the imposition of a confiscatory rate * * * it is evident that past experience is an indication of the company's requirements for the future. * * * The experience of the Illinois company * * * should afford a sound basis for judgment as to the amount which, in fairness both to public and private interest, should be allowed as an annual charge for depreciation."

In the case of the New York Teleph. Co. v. Prendergast (1929) 36 F. (2nd) 54, P. U. R. 1930B, 33, 52, in which case the statutory court held that the amount in the depreciation reserve was the best evidence of the amount of actual depreciation which had accrued, the Court said:

"Either the property has in fact depreciated to the extent of the depreciation reserve which has been created, or it has not. If it has not, the plaintiff has been allowed to take money from its ratepayers under the claim of depreciation which was not there, either seen or unseen, and which it will never have to admit. In that case, the excess reserve has been acquired lawfully and is the property of

the plaintiff. But if the actual depreciation exists to the extent that the plaintiff has claimed in building up this reserve, it exists as much for valuation purposes as it did for the creation of the surplus. Whether or not the plaintiff admits the depreciation now, or must do so in the future, is unimportant, *for it is there, and the time of its admission is immaterial on the question of its existence.* If, as claimed by the plaintiff sound honest business methods have been followed and the straight-line method pursued by it was not excessive, the depreciation reserve, when added to the property now or at any time, would be no more than sufficient to keep the actual value of the property con- [fol. 31] stant. The record satisfactorily shows that there is more reason to believe that the actual existing depreciation in the plaintiff's property is reflected by the amount of its reserve for depreciation than that is shown by the estimates of experts who stated observed depreciation, which sum only was deducted by the master. For these reasons, the plaintiff has failed in the burden, resting upon it, to prove that the reserve depreciation was greater than the actual depreciation, both seen and unseen, as measured by the depreciation reserve.

• • • "When it built up its reserve, it claimed the reserve as its actual depreciation. It cannot now take an inconsistent position about depreciation, without fully establishing it, and it has weakened its proof of present value accordingly. The plaintiff was right about depreciation when it created its reserve, and it is wrong, in its position now, in its claim for a lesser sum as actual depreciation in this effort to establish fair value."

In the recent case, Re: The Ohio Bell Telephone Company reported in Public Utilities Fortnightly, March 29, 1934, the Ohio Commission in fixing a composite rate of 4% on the depreciable property said:

"We believe that there is a direct relationship between the condition per cent of a public utility property and its history as to retirements on the one hand, and the allowance that should be made annually for depreciation on the other."

This identical question was before the Maryland Commission in the recent case, Re: Chesapeake & Potomac

Telephone Co. reported in Public Utilities Fortnightly, February 15, 1934. The company's witnesses testified that the property was in 86.82 per cent condition and the company claimed a deduction from reproduction cost new should not exceed 13.18 per cent. For seventeen years the Maryland Commission had taken the position that the reserve for accrued depreciation should not exceed 20 per cent of the value of the physical property and this position has been concurred in by the respondent. That Commission held:

"*Estimation of Accrued Depreciation Based on Reserve* —A depreciation reserve of not more than 20 per cent of the value of the physical property of a telephone plant ordered by the Commission in former years to be set up [fol. 32] (with the understanding that it was to be the property of the utility's consumers held in trust by the utility) was held to be a fairer measure of the amount of accrued depreciation than a claim for an accrued deduction of only 13.18 per cent, based upon the superficial inspection of the property by appraisal engineers, since the concession of the later claim would amount to an admission that the utility had been annually charging subscribers more than necessary in order to build up the amount in the reserve, p. 373."

In the above case, the Maryland Commission said:

"Moreover, if the company really believes the amount in the depreciation reserve is in excess of the actual depreciation existing in the company's property—depreciation that may be unseen as well as that which can be seen—and this depreciation amounts to no more than 13.18 per cent, then it would seem, if the company is correct, that it has been collecting from the people more than it had any right to collect under the agreement which was intended to be fair to the public as well as to the company, and that the proper thing to do would be to cut down the amount allowed for depreciation until it will indicate a depreciation to the extent of not more than 13.18 per cent of the fair value of the company's property. The conclusion is inescapable that if the depreciation, seen and unseen, of the company's property does not equal the amount set aside to take care

of it, then the company has been taking from its customers more than that to which it is rightfully entitled."

In view of the differential between respondent's accrued depreciation and the reserve for accrued depreciation, together with the decreased importance of the growth factor in determining service life, the Maryland Commission fixed a composite rate of 3.57 per cent of the book cost of depreciable property and 3.45 per cent of the total book cost of fixed capital.

In re: 14700, Depreciation Charges of Telephone Companies, decided on July 28, 1931, the Interstate Commerce Commission held:

"The principles are identical which govern the estimating of loss in service capacity for both accounting and valuation purposes. The same elements which produce depreciation for accounting purposes likewise produce depreciation for valuation purposes and they cannot properly be observed and taken into account in the one case and at the same time be overlooked and neglected in the other."

[fol. 33] We do not say that a depreciation reserve of more than 20 per cent of the value of the physical property is sufficient in all cases to take care of accrued depreciation. We do say that a depreciation reserve of 24.24 per cent of the value of physical property is more than sufficient to take care of 12 per cent accrued depreciation or an 88 per cent condition. The gradual reduction of its annual depreciation rates from 5.2 per cent in 1925 to 4.67 per cent in 1932 and a proposed rate of 4.48 per cent for the year 1934, is an admission that its rates have been too high in the past.

A reserve for accrued depreciation is closely connected with maintenance. The respondent's property in Nebraska has been and now is maintained in the highest state of efficiency. The service life of physical units of a public utility is very similar to the life expectancy of persons. The service life of physical units of a public utility is increased by proper maintenance. The life of a person is likewise increased by observing proper rules of hygiene. In determining the service life of the physical units of a public utility, maintenance becomes an important factor. The

following table discloses the amounts by years expended by the respondent for replacements from its depreciation reserve, and the amount expended for maintenance:

Date	From Depreciation Reserve	For Maintenance
1921	$1,656,816.10	$3,474,031.19
1922	2,137,835.24	3,622,494.58
1923	1,461,779.15	3,798,722.82
1924	2,269,399.29	3,924,051.03
1925	2,486,719.90	4,346,971.11
1926	2,715,976.29	4,455,015.74
1927	3,915,796.07	4,902,366.88
1928	5,028,398.45	5,172,254.40
1929	4,833,785.71	5,885,249.76
1930	5,203,226.05	6,361,827.47
1931	5,901,020.68	6,023,914.15
1932	4,277,488.36	5,253,887.56
Total	$41,888,241.36	$57,220,786.69

[fol. 34] The above figures show that in 12 years, the respondent spent $15,332,545.42 more for maintenance than it spent from its depreciation reserve for replacements. In Re: Ohio Bell Telephone Company, supra, the Ohio Commission said:

"An important factor in determining the proper depreciation allowance is the maintenance policy of the company under consideration. This company has from the time of the merger in 1921 carried on a high standard of maintenance and kept its property in good condition and in a high state of efficiency. The line of demarcation between maintenance charge and depreciation charge is often quite dim and undoubtedly many items properly chargeable to reserve are handled as maintenance expense. Charges that would be considered a major requirement to a smaller utility are merely routine maintenance matter to a utility of the size of the present company.

"This Commission found at the time of fixing a tentative valuation of the property that the depreciable property of this company was on the date certain in an 87 per cent condition. To maintain that condition the company expended from the time of the merger to the date certain in the way of expenses for current maintenance and repairs the sum of $16,385,139 and during the same period the net charges to reserve for depreciation amounts to $11,349,664. From the date certain to December 31, 1931, the company paid out in the way of expense for current maintenance and repairs

the sum of $42,064,639 (a very liberal sum), and its net charges to reserve for depreciation for the same period were $40,956,301.

"We are especially concerned with the practice of the company in maintaining its property as of the date certain and for the years prior thereto for the reason that the value of the plant as of the date certain is the base upon which the return to the company is computed."

As compared with the Ohio Company the respondent has during the same years, spent a much larger sum for maintenance. This would indicate either that the respondent has maintained its Nebraska properties in a higher state of efficiency or that on account of deferred maintenance in 1921, it was necessary to spend more to bring respondent's property into a state of efficiency equal to the Ohio Company.

In ascertaining the amount required for annual depreciation it is first necessary to determine the service life of the [fol. 35] several units of depreciable property. The factors determining service life are decay, wear and tear, physical deterioration, current action of the elements, obsolescence, inadequacy, demands of public authority and such other factors that are not restored by current maintenance. In determining accrued depreciation or percentage condition for ascertaining the fair value for rate making purposes, valuation engineers make inspection of the property to determine observed deterioration and do not give full consideration, to the factors which determine the service life of the several units of property. We hold that the same factors should be considered by valuation engineers that are considered by the plant engineers and accountants in determining the required amount of annual depreciation. The differential of the respondent's actual depreciation and its depreciation reserve is probably due to this situation. The instant case presents a situation where it is the duty of the Commission to reduce the annual depreciation rate so it will gradually bring the accrued depreciation and the depreciation reserve into a fair relationship.

It was disclosed at the hearing and it is a well known fact that in the past the most important factor in estimating annual depreciation rates has been growth, requiring displacements on account of inadequacy. It is the opinion of the Commission that this factor will be of little importance

during the year of 1934 and for several years to come. Exhibit 5 submitted by the Commission shows the population of cities and towns in Nebraska for 1910, 1920 and 1930, as disclosed by the U. S. Census, of the cities and towns where respondent operates exchanges. For 94 cities and towns the average growth in population from 1910 to 1920 was 1,034, and from 1920 to 1930 was 459. In 7 cities of more than 5000 population the average growth was 8007 from [fol. 36] 1910 to 1920 and 5208 from 1920 to 1930. In four cities between 3000 and 5000 the average growth was 1169 from 1910 to 1920 and 582 from 1920 to 1930. In 83 cities and town of less than 3000 population the average growth was 146 between 1910 and 1920 and 52 between 1920 and 1930. It is therefore fair to conclude that the growth due to increased population will be less between 1930 and 1940 and that inadequacy arising from increase of population will be less in 1934 and for several years to come than it has been prior to 1930.

Exhibit 6 submitted by the Commission shows the average number of respondent's Nebraska stations on December 31, 1929, and until December 31, 1933, as follows:

	Business	City Residence	Rural	Total Company Owned	Service Stations	Total All Stations
Dec. 31, 1929	35,908	67,698	9747	113,353	10622	123,975
Dec. 31, 1930	37,207	69,237	9813	116,257	10584	126,841
Dec. 31, 1931	37,039	67,199	8403	112,641	10251	122,892
Dec. 31, 1932	34,500	59,569	5952	100,021	9779	109,800
Dec. 31, 1933	33,209	55,652	5006	93,867	8691	102,558

It is fair to assume that in 1929 the respondent had a reserve capacity in plant investment to take care of increasing business. Exhibit 6 disclosed that from December 31, 1929, to December 31, 1933, it has lost 21,417 stations or more than 17 per cent. If in 1929 the respondent had no reserve capacity, it now has a reserve capacity in an amount in excess of 17 per cent. This would indicate that inadequacy arising from growth will not be an important factor for 1934 and for several years thereafter. It should be out of the picture entirely as far as those exchanges are concerned in cities and towns of less than 3000 population.

In Re Chesapeake & Potomac Telephone Company, supra, the Maryland Commission said:

"(7) With respect to currently accruing depreciation, people's counsel contended that the steady and uninter-

rupted expansion of the company's business in the past has made "inadequacy" the controlling factor in determining the service life of most of the elements of the property and [fol. 37] that service life, so limited by inadequacy, would of course be shorter than the service life of similar property employed in a stationary or shrinking business, which property would be retired only when physical deterioration or ordinary obsolescence required. It was argued that, because the business of this company has now ceased to expand and has experienced a substantial shrinkage in recent months, it is reasonable to assume that in the immediate future, and for a period of several years, the present plant will be more than adequate and service life of plant will be terminated solely by physical depreciation or ordinary obsolescence and will, therefore, with respect to those units of plant heretofore retired because of inadequacy, be materially lengthened.

"It necessarily follows that if the service life of plant be lengthened, the amount which must be set aside annually, out of revenue, to provide for retirements is correspondingly reduced.

"If, in the past, inadequacy had been a determining factor in the retirements of all classes of property and had required for each class a substantially higher annual allowance for retirements than would have been necessary to account for physical depreciation and obsolescence, then it might have been reasonable, until such time as lost business had been recovered and growth was resumed, to suspend accruals to the reserve until it was adjusted to the changed conditions.

"The company points out that it is required by the Interstate Commerce Commission to base depreciation accruals upon "The straight-line theory" which contemplates uniform annual accruals which will aggregate the amount of the original cost of the item at the time of retirement. This Commission approves of the straight-line method of accounting for depreciation, but understands that the line remains straight only so long as original assumptions prevail, and that every change in the estimate of service life must produce a variation from the straight line previously determined for the class of property affected. The closest adherence to the straight line method requires adjustments to accrual rates whenever conditions change, and when a

change occurs of such magnitude and far-reaching effect as the present business depression, it is bound to have a very noticeable effect upon the proper rate of accruals for retirements in what has been, heretofore, a steadily expanding property."

In considering all of the evidence, we are of the opinion that a composite rate of 3½ per cent upon depreciable property including right-of-way, would be a liberal allowance for 1934.

Findings and Conclusions

We therefore find and conclude:

1. That the respondent's depreciation reserve of 24.24 per cent of its depreciable plant investment is more than is required to take care of actual depreciation of 12 per [fol. 38] cent and that the rate proposed by the respondent of 4.48 per cent for 1934 is excessive.

2. That the factor of inadequacy arising from growth will not be as important a factor in 1934 as it has been in the past and that respondent's proposed rate of 4.48 per cent will not be required for 1934.

3. That the differential now existing between respondent's depreciation reserve and its actual depreciation should be gradually reduced until its depreciation reserve more correctly reflects its actual depreciation.

4. That respondent's proposed depreciation rate of 4.48 per cent should be reduced until its present excess reserve capacity for service has been absorbed.

5. That a depreciation rate of 3½ per cent upon depreciable property including right-of-way be applied by the respondent for the year 1934.

Order

It is therefore ordered by the Nebraska State Railway Commission that the composite depreciation rate of the Northwestern Bell Telephone Company be and the same is hereby fixed at 3½ per cent upon all of its depreciable property including right-of-way in Nebraska for the year 1934.

It is further ordered that the Northwestern Bell Telephone Company be and is hereby directed to use a composite rate of 3½ per cent up on all of its depreciable property in Nebraska including right-of-way, for the year 1934 for purposes of accounting and reporting to the Nebraska State Railway Commission.

Made and entered this 9th day of April, 1934, at Lincoln, Nebraska.

[fol. 39] Nebraska State Railway Commission,
(Signed) C. A. Randall, Chairman. (Seal.)

Attest: (Signed) Mary E. Sheehan, Acting Secretary.

Commissioners Concurring: (Signed) F. L. Bollen. (Signed) Hugh Drake.

BEFORE NEBRASKA STATE RAILWAY COMMISSION

In the Matter of Depreciation Charges for Class "A" and Class "B" Telephone Companies

Re NORTHWESTERN BELL TELEPHONE COMPANY

MOTION FOR REHEARING—Filed April 12, 1934

Comes now Northwestern Bell Telephone Company, respondent herein, by its attorneys F. E. Randall and Tracy J. Peycke, and respectfully moves the Commission to vacate and set aside its order made and entered herein on the 9th day of April, 1934, and to grant a rehearing and a new trial herein upon the following grounds, to-wit:

1. Irregularity in the proceedings of the Nebraska State Railway Commission by which the respondent was prevented from having a fair trial.

2. That the order is not sustained by sufficient evidence and is contrary to law.

3. That the said order was made without notice to respondent in that respondent had been given no notice that the Commission contemplated the making of any order [fol. 40] affecting the rates of depreciation charged by respondent during the year 1934.

4. That the said order was made without affording to the respondent an opportunity to be heard, in that the

order for hearing herein limited the scope of said hearing to an oral examination of the members of respondent's staff who prepared certain schedules which had been filed with the Commission, and the introduction of such evidence as the Commission desired to submit, and in that respondent had been given no notice that the said hearing was for the purpose of determining the propriety or lawfulness of any order contemplated to be made by the Commission affecting or modifying the depreciation rates of respondent for 1934.

5. That the said Commission had no jurisdiction to make and enter the said order.

6. That the said order is illegal and void and in excess of the powers of the Commission and in violation of the constitution and laws of the State of Nebraska and the constitution and laws of the United States.

(Signed) F. E. Randall, (Signed) Tracy J. Peycke, Attorneys for Respondent, Northwestern Bell Telephone Company.

[File endorsement omitted.]

BEFORE NEBRASKA STATE RAILWAY COMMISSION

MINUTE ENTRIES

And afterwards to-wit: on April 17th, April 19th, April 24th, and May 2nd, 1934, the following entries were made in the records:

Lincoln, Nebraska, April 17, 1934.

The Commission met in regular session April 17th, 1934, with all members present.

* * * * * * *

Commissioner Drake moved that a certified copy of the opinion, findings and conclusions and order, in General Order No. 59 be sent to the attorney for the Northwestern [fol. 41] Bell Telephone Company. The motion carried.

* * * * * * *

Lincoln, Nebraska, April 19, 1934.

The Commission met in special session April 19, 1934, with all members present.

* * * * * * *

The motion for rehearing filed by the Northwestern Bell Telephone Company in General Order No. 59 was set for hearing April 25, 1934, at 10:00 a. m. in the Commission's hearing room.

* * * * * * *

Lincoln, Nebraska, April 24, 1934.

The Commission met in regular session with all members present.

* * * * * * *

Oral argument on Depreciation Charges of the Northwestern Bell Telephone Company in General Order No. 59 which was to be heard on April 25, 1934, was set for hearing on May 2, 1934, 10 o'clock a. m. at the request of the Northwestern Bell Telephone Company.

BEFORE NEBRASKA STATE RAILWAY COMMISSION

MINUTE ENTRIES

Lincoln, Nebraska, May 2, 1934.

Pursuant to notice previously given, oral argument on the motion of the Northwestern Bell Telephone Company for rehearing and new trial in General Order No. 59 was held and submitted thereon.

* * * * * * *

And afterwards to-wit: on the 15th day of May, 1934, the following entry was made in the records of the Commission:

Lincoln, Nebraska, May 15, 1934.

The Commission met in regular session Tuesday, May 15th, 1934, with all members present.

* * * * * * *

[fol. 42] Commissioner Bollen moved that the motion for rehearing filed by the Northwestern Bell Telephone Com-

pany in General Order No. 59 be overruled. Roll was called and the Commissioners voted as follows: Bollen, yes; Drake, no; Randall, yes. The motion carried, and the order overruling said motion for rehearing was concurred in as follows:

BEFORE NEBRASKA STATE RAILWAY COMMISSION

General Order No. 59

In the Matter of Depreciation Charges for Class "A" and Class "B" Telephone Companies

RE NORTHWESTERN BELL TELEPHONE CO.

Appearances:

Tracy Peycke, Attorney for Northwestern Bell, Omaha, Nebraska.

ORDER OVERRULING MOTION FOR A NEW TRIAL—May 15, 1934

By the COMMISSION:

This cause again came on for hearing this 15th day of May, 1934, upon the motion of respondent for a rehearing and a new trial and after argument by the respondent's attorney, the Commission being fully advised in the premises find that the motion of the respondent should be overruled.

While not specifically raised by respondent's motion for a rehearing and a new trial, upon argument, the counsel for respondent pointed out that the order of the Commission entered herein did not specifically state that the composite depreciation rate applied only to respondent's depreciable property situated in Nebraska. This Commission would be without jurisdiction to fix a depreciation rate for the property of the respondent situated outside of the state of Nebraska unless that property was used and useful in rendering telephone service in Nebraska. The respondent's general offices are located at Omaha and the property used for its general offices is used and useful in [fol. 43] other states but we do not know of any property outside of Nebraska used and useful for rendering service

in Nebraska. Our order entered herein on the 9th day of April, 1934, does state:

"It is therefore ordered by the Nebraska State Railway Commission that the composite depreciation rate of the Northwestern Bell Telephone Company be and the same is hereby fixed at 3½ per cent upon all of its depreciable property including right-of-way in Nebraska for the year 1934."

We therefore find that this paragraph should read as follows:

"It is therefore ordered by the Nebraska State Railway Commission that the composite depreciation rate of the Northwestern Bell Telephone Company be and the same is hereby fixed at 3½ per cent upon all of its depreciable property in Nebraska including right-of-way, for the year 1934."

It is therefore ordered by the Nebraska State Railway Commission:

1. That the motion of the respondent for a rehearing and a new trial be and the same is hereby overruled. Respondent excepts.

2. That the first paragraph of the order entered on April 9, 1934, be and the same is hereby amended to read:

"It is therefore ordered by the Nebraska State Railway Commission that the composite depreciation rate of the Northwestern Bell Telephone Company be and the same is hereby fixed at 3½ per cent upon all of its depreciable property in Nebraska including right-of-way, for the year 1934."

Made and entered at Lincoln, Nebraska, this 15th day of May, 1934.

Nebraska State Railway Commission, (Signed) C. A. Randall, Chairman. (Seal.)

Attest: (Signed) J. F. Miller, Secretary.

Concurring Commissioner: (Signed) F. L. Bollen.

[fol. 44] BEFORE NEBRASKA STATE RAILWAY COMMISSION

General Order No. 59

In the Matter of Depreciation Charges for Class "A" and Class "B" Telephone Companies

In re NORTHWESTERN BELL TELE. CO.

Motion for Retrial

DISSENTING OPINION

Commissioner DRAKE, Dissenting:

This matter is now before this Commission upon motion of the Northwestern Bell Telephone Company to set aside the order herein of April 9th, 1934, and to grant a rehearing. The motion, which is on file and a part of the record in this case, was made upon various grounds challenging the jurisdiction of this Commission and the basis in law and in fact for an order such as has been entered. The principal ground urged upon the argument in support of the motion was that the order was not preceded by and based upon any proper notice to respondent, with opportunity to be heard.

An examination of the records herein disclose this argument to be based upon facts which are true, and the Commission should reach the conclusion that the position is well taken. Should the Commission refuse to set aside the order, it is unnecessary to review the other faults in the order, but if it should do what is fair and reasonable, the other matters complained of can be properly presented at further hearings for the proper consideration they deserve when the matter has been properly heard upon its merits.

Let us review the proceedings herein. The first step was the order on November 29th, 1933. It recites some of the history of the proceedings had by the Interstate Commerce Commission up to that time, including the following statement:

"Docket No. 14700 is a master study of depreciation accounting, and the principles there enumerated should be adopted by this Commission as a basis for depreciation accounting."

The order of this Commission herein on April 9th, evidently precludes any further action of this Commission in line with the views and purposes expressed in such order of November 29th, 1933.

As to procedure, the following was laid down:

[fol. 45] "The Commission is of the opinion and so finds that the procedure adopted by the Interstate Commerce Commission for prescribing depreciation rates, should be adopted by this Commission, except that when the Interstate Commerce Commission shall have prescribed the rate of depreciation after hearings by this Commission and recommendations of this Commission thereon, the said rate should not be final, as far as accounting to this Commission is concerned, but subject to review by this Commission and a final order entered thereon."

This part of the first order in no uncertain terms, informs the respondent just what procedure is going to be followed, to-wit: An investigation, independent of but during the same period of time, contemplating that a copy of the record made being furnished to the Interstate Commerce Commission, together with our recommendations therein. All with the clear intention of then awaiting the formal decision of the Interstate Commerce Commission, a tribunal having concurrent jurisdiction, but having exercised such jurisdiction prior to our order, before the entering of any final order by this Commission.

It is then ordered that Class "A" and Class "B" telephone companies file with this Commission, not later than March 1st, 1934, August 1st, 1934 and August 1st, 1935, respectively, data prescribed by the Interstate Commerce Commission. The order then concluded:

"4. That the procedure adopted by the Interstate Commerce Commission for prescribing depreciation rates be and the same is hereby approved, except that this Commission reserves the right to review the findings and conclusions of the Interstate Commerce Commission and *enter a final order thereon,* as to the depreciation rate for accounting purposes to this Commission." (Italic is mine.)

But, contrary to the above, a final order was issued on April 9th, 1934.

On March 6th, 1934, the following order was made:

"Pursuant to our order of November 29, 1933, the Northwestern Bell Telephone Company has filed with the Commission its schedule of depreciation rates by primary accounts which it proposes to apply for the year 1934, together with the supporting data as required by the Interstate Commerce Commission in Schedules 1 and 2 of Circular 7, Depreciation Section Series, and the same having [fol. 46] been examined by our engineering staff and not being fully satisfied with the rates proposed, we find that the cause should be set down for hearing for oral examination of the members of respondent's staff, who prepared said schedules, and for the introduction of such evidence as the Commission may desire to submit with opportunity of objections and cross-examination by respondent.

"It is therefore ordered that the cause be set down for hearing on the 19th day of March, 1934, at the hour of 10 A. M., at the Commission's hearing room in the State Capitol."

Thus, at the conclusion of a superficial examination of the data that was furnished, a final order was entered.

The respondent submitted oral argument in support of a setting aside of the said order, and among other important issues raised in such argument, alleged it was their position that it had no notice by virtue of what thus preceded, that this Commission contemplated making a final order at this time fixing a depreciation rate for 1934; that it was justified in interpreting the order of March 6th as simply directing (if you please) it to produce certain witnesses for interrogation, as stating no issue for determination and as furnishing it no opportunity to present evidence or make argument concerning any matter to be decided by us; that the order actually made herein cannot be obeyed without bringing respondent into conflict (and probably contempt) with regulations and orders imposed by the Interstate Commerce Commission, which this Commission had expressly approved and adopted by its order of November 29th, 1933.

It was argued by respondent that it properly interpreted the hearing held March 19th and 20th as a step in the procedure already adopted of securing information to enable

this Commission to make recommendations to the Interstate Commerce Commission following August 1, 1934, and generally to cooperate with the said Federal Commission.

It is not necessary to go into these matters at length. The Commission did, at conclusion of the hearings, order [fol. 47] a copy of the record to be prepared for the purpose of forwarding to the Interstate Commerce Commission together with our recommendations, and in line with such procedure I can agree that our order of April 9th could and should be changed from an "Order" to a "Recommendation", and then, together with a copy of the record, such as it is, forwarded to the Interstate Commerce Commission for their information and guidance.

Regardless of any technical considerations, it is and should be the constant purpose of this Commission to afford to all parties subject to its jurisdiction, ample notice and full opportunity to be heard. Respondent seriously urges that these rights have not been accorded it in an important matter, and states the grounds which should be sustained. So grave an order as one requiring accounting practices, which if followed, involve serious penalties under federal laws which purport to be applicable, should certainly not be made without notice and hearing which leave no question as to their adequacy. Even tho all the members of the Commission are not well versed in the principles of law, the Commission should, in rendering its decision, follow some of the common and well known principles, one of which is as follows:

"A full hearing is one in which ample opportunity is afforded to all parties to make, by evidence and argument, a showing fairly adequate to establish the propriety or unpropriety, from the standpoint of justice and law, of the step asked to be taken."

No possible prejudice can possibly result from a reopening of this matter. Under the statutes of Nebraska the Annual Report from respondent for 1934, is not due until after January 1st, next. Any order which the Commission may, after a complete investigation, think it proper to make will be equally effective if entered after such proper hearing. In any event, there can be no wisdom in making an order which is beset at its inception with the seri-

ous and unnecessary question as to its validity upon questions of procedure. It was my view at the time the order [fol. 48] was proposed, that the rate of depreciation fixed in the order was adequate. However, I did not consider the serious questions involved, and at that time concluded that the procedure had been correct, and now consider that the question of procedure is wholly apart from the merits of the rate question. I agree that if this were a rate case, instead of an accounting question, with the same facts presented, and presented in a properly conducted and concluded case, that I would probably agree as to the rate, but the present proceeding is not a rate case. If the order entered herein is valid, upon the same theories we can then issue an order which would set out the salaries which respondent could enter on its records as expense items for 1934. We do have the authority, in a rate case, to say what are reasonable items of expense for depreciation and for officers' salaries and other expenses, but I seriously doubt any jurisdiction to do so in an accounting investigation.

The order of April 9th, 1934, should be vacated and the matter set down for rehearing upon a notice which will specifically set out the issues involved and the action contemplated. The evidence already received should remain a part of the record in this proceeding. Upon such rehearing. respondent should have full opportunity to make such objections as it may desire to the jurisdiction of this Commission, to present evidence and make arguments pertinent to any issue there involved. A refusal to do this is wrong, it is illegal and very unethical. An attorney might "get by" with "sharp" practice in taking advantage of an opponent, but the Commission should not be guilty of such practices. Certainly a respondent who is ordered to come into court is entitled to his full day in court, and no advantage must be taken. It was common knowledge that the [fol. 49] two day hearings on March 19th and 20th, 1934, were considered by members of the Commission as a "school of instruction", and by the respondent as a compliance to an order by the Commission to demonstrate to it some of the methods, plans, etc., which were going to be used in "proving in" the life of property in hearings before the Interstate Commission. The respondent offered no testimony. The Commission questioned several of its employees as to the work they were doing. Certainly there

was no hearing which must be contemplated in view of any final order of this Commission.

(Signed) Hugh Drake, Commissioner.

BEFORE NEBRASKA STATE RAILWAY COMMISSION

General Order No. 59

In the Matter of Depreciation Charges for Class "A" and Class "B" Telephone Companies

Re NORTHWESTERN BELL TELEPHONE COMPANY

STIPULATION CONCERNING UNIFORM SYSTEM OF ACCOUNTS—Filed May 18, 1934

It having been orally stipulated and agreed upon the [fol. 50] hearing of the motion of respondent for a rehearing herein that the Uniform System of Accounts for Telephone Companies, First Revised Issue, prescribed by the Interstate Commerce Commission, might be considered and treated as in evidence in these proceedings, and said stipulation not otherwise appearing of record herein.

It is hereby stipulated and agreed that said Uniform System of Accounts may be treated as in evidence in these proceedings as fully as if this stipulation had been made and filed prior to the making of a final order herein.

Nebraska State Railway Commission, (Signed) by C. A. Randall, Chairman. (Seal.)

Attest: (Signed) J. F. Miller, Secretary.

Northwestern Bell Telephone Company, (Signed) by F. E. Randall, (Signed) Tracy J. Peycke, Its Attorneys.

[File endorsement omitted.]

BEFORE NEBRASKA STATE RAILWAY COMMISSION

MINUTE ENTRY

Lincoln, Nebraska, June 29, 1934.

The Commission met in special session, Commissioners Randall and Bollen present, Commissioner Drake absent.

* * * * * * *

The Commission considered Notice of Appeal by the Northwestern Bell Telephone Co. in General Order No. 59 and the request by said company for the Commission to fix the amount of the Appeal Bond. On motion the said bond was fixed in the amount of $100.00.

[fol. 51] Before Nebraska State Railway Commission

General Order No. 59

In the Matter of Depreciation Charges for Class "A" and Class "B" Telephone Companies

Re Northwestern Bell Telephone Company

Notice of Intention to Prosecute Appeal—Filed June 29, 1934

Notice is hereby given that the Northwestern Bell Telephone Company, respondent above named, being affected by that certain order of said Nebraska State Railway Commission made on the 9th day of April, 1934, as the same was amended by an order of said Commission made on the 15th day of May, 1934, whereby said Nebraska State Railway Commission purported to fix and establish the depreciation rate of respondent upon its depreciable property in Nebraska for the year 1934, intends to institute and prosecute an appeal to and proceedings in the Supreme Court of Nebraska to reverse and vacate said order of the Nebraska State Railway Commission, and applicant requests said Commission to fix cash bond herein.

(Signed) Northwestern Bell Telephone Company, by F. E. Randall and Tracy J. Peycke, Its Attorneys.

[File endorsement omitted.]

[fols. 52 & 53] Bond on appeal for $100.00, approved and filed July 2, 1934, omitted in printing.

[fols. 54 & 55] Certificate to foregoing transcript omitted in printing.

[fols. 56 & 57] BEFORE NEBRASKA STATE RAILWAY COMMISSION

General Order No. 59

In the Matter of Depreciation Charges for Class "A" and Class "B" Telephone Companies (NORTHWESTERN BELL TELE. CO.)

Bill of Exceptions Filed in Supreme Court—Filed July 3, 1934

Transcript of Testimony Taken at Hearing Held in the Offices of the Nebraska State Railway Commission at Lincoln, Nebr., on March 19th and 20th, 1934, All Commissioners Sitting. Commissioner Bollen Presiding.

[fol. 58] APPEARANCES

For the Northwestern Bell Telephone Co.: F. E. Randall, General Counsel, Omaha, Nebraska. Tracy J. Peycke, Attorney, Omaha, Nebraska.

For the Commission: B. E. Forbes, Chief Engineer.

[fol. 59] Be it remembered that heretofore, to-wit, on the 19th day of March, 1934, pursuant to notice previously given, the Commission sat in the offices of the Nebraska State Railway Commission at Lincoln, Nebraska, with Commissioner Bollen presiding, at the hour of 10 o'clock a. m., for the purpose of hearing testimony in re General Order No. 59.

By Commissioner Bollen: What order of procedure would you think proper, gentlemen?

By Mr. Peycke: We have brought down Mr. Granfield, who is our cost engineer, and has to do principally with the calculation of these depreciation rates, and is in charge of that, and he's here for whatever questions the Commission may care to ask. And we also have Mr. Teal, one of Mr. Granfield's assistants, who has rather a specialized acquaintance with some of these matters, and also Mr. Baird, our General Auditor, if there are any accounting questions you care to inquire into. We will be glad to have the Commission ask these gentlemen any questions that they care to, and we will be very glad to have them answer them and

furnish any information they can. I think Mr. Granfield perhaps is the person who has most of this information, and would be the one to start with.

(Discussion off the record.)

Mr. T. H. GRANFIELD, being first duly sworn to tell the truth, the whole truth, and nothing but the truth, testified as follows:

[fol. 60] Direct examination.

By Mr. Peycke:

Q. Have you stated your full name Mr. Granfield?

A. Yes, sir.

Q. And you are employed by the Northwestern Bell Telephone Company?

A. I am.

Q. What is your position with the company?

A. Inventory and costs engineer.

Q. And in a general way, what duties does that involve?

A. That involves the carrying on of engineering studies that relate to the entire company, instead of to just one area, and the carrying on of studies relating to the development of the depreciation rates for the company; general supervision of engineering features of valuation work; studies of construction costs; annual construction programs, and similar studies pertaining to the company as a whole.

Q. And with a little more particularity, what do you have to do with the calculation of rates of depreciation?

A. The rates of depreciation are compiled entirely under my direction. The data on which the rates are based are collected from all parts of the territory in which the company operates, and analyzed in my office, and the results are considered there with reference to future developments or trends which may affect them in the future, and the final results of both the analysis of experience and application of judgment are the basis for the rates of depreciation which I recommended to the management for use in our current accounting.

Q. How long have you been in the employment of the Northwestern Company?

[fol. 61] A. Since January, 1916.

Q. And how long a period of time have you been engaged in having to do with calculation of depreciation rates and similar matters?

A. For the past seven or eight years the calculation of depreciation rates and associated data has been one of my principal duties.

Q. And back of that, have you had some engineering training, and what is the nature of it?

A. I had four and a half years training in the University of Minnesota, four years undergraduate work, principally in the engineering and mining schools, and half year in the graduate school; and I had all told, three or four years engineering experience in the manufacturing field with the General Electric Company and I had considerable training in the military communications field while in the Army, attending radio officers schools at Columbia University, and several military posts.

Q. During the time that you have been engaged in handling depreciation matters for the Northwestern Company, have you made it your business to endeavor to keep advised as to the learning in that field, and the experience of other companies and bodies that have to do with the calculation of depreciation rates?

A. Yes, I have.

Q. Are you familiar with the tabulation of data which Mr. Baird filed with the Interstate Commerce Commission, and copy of which he filed with this Commission about March 1st of this year?

A. Yes, sir.

[fol. 62] Q. And did you furnish him with the data which are contained in that tabulation?

A. Yes, sir.

By Mr. Peycke: Now if the Commission please, we will be glad to have Mr. Granfield asked any questions that the Commission desires. We don't know what the Commission is particularly interested in here, and haven't come prepared to make any comprehensive examination of this matter, but I think Mr. Granfield can turn to any matter the Commission is interested in and will be glad to do so.

By Commissioner Bollen: I assume he prepared this exhibit of data?

By Mr. Peycke:

Q. Is that true, Mr. Granfield?

By Mr. Granfield:

A. Did what?
Q. Prepared the data filed with the Commission?
A. Yes, that was prepared in my office.

By Commissioner Bollen: Would it not be better for you to have him explain all matters in connection with this data, and let Mr. Forbes cross-examine him?

[fol. 63] By Mr. Granfield: I think it is altogether too comprehensive a matter to undertake to give anything approaching a detailed explanation of this matter without the use of a good many exhibits and charts, which have not yet been prepared, but which are in course of preparation; and which will form the material which will be filed next August.

By Commissioner Bollen: Which way would you prefer to proceed, Mr. Forbes?

By Mr. Forbes: I would prefer that we have a complete showing at one time. I would like to have all the data in the record that the company might expect to put in, and a complete explanation. I fear if we proceed at this time to go into the details, we may lose information that will be of considerable value to us in the future. I understand that the company has supporting data and sheets that they are now preparing.

By Mr. Peycke: That is true. Of course the company has to have the supporting data before it can reach these rates, and of course we don't represent that we don't have the information, but it is necessarily exceedingly voluminous, and until the work is done to consolidate it and get it into sheets and exhibits and tabulations, which is the goal that we are aiming at in connection with the material which will be filed August 1st in accordance with the Interstate Commerce Commission's order, and this Commission's order, it is hardly possible to go into the things except by a very laborious process of going through, I don't know, it may [fol. 64] be hun-reds of thousands of work sheets.

By Commissioner Bollen: I think Mr. Forbes, your position would be good if this was August 1st instead of March 1st. This is simply for the fixing, of course, of the 1934

rate, and the Interstate Commerce Commission and we did not require as full a showing at this time as we expect to require for the 1935 rate. I wonder if it wouldn't be better for you to secure all the information you can from the data now submitted, and then if we want anything further for this particular hearing, have them prepare it for us.

By Mr. Forbes: Do I understand, Mr. Granfield, you are preparing graphs showing the trend and the life of different classes of property—in all classes—and things of that sort?

By Mr. Granfield: Yes, sir. For each class of plant we have the history summarized and are preparing brief texts discussing the factors that have been considered, and a summary of the historical data and an outline of the analysis giving the exact calculation of the service life and the salvage that has been realized, and that summary will be the result of summarizing an enormous volume of data. It takes thousands of pages, literally, to assemble these data of property units, and gradually boil them down into summaries that can be checked over in a reasonable time. For instance, we have volumes two or three inches thick giving the history of poles alone in one area, and that was sum- [fol. 65] marized and concentrated into a form from which the analysis was made, and the computation of the service life, by whatever method is used, will be shown in detail, and charts showing trend in service life and salvage for each class of plant.

Q. Do I understand you may change these percentages?

A. We are not expecting to, no sir, but the data on which these percentages are based have not been summarized in a form that makes it convenient to present them and check them over. For instance, if I should give you all the data we now have back of our pole line depreciation rate, for example, it would mean pretty near a separate set-up for indexing purposes, because it is so voluminous that if it is not concentrated into a brief form, it would take considerable time to go through the data and check out the answer.

By Commissioner Bollen:

Q. You didn't expect to have that prepared for this hearing, did you?

A. No, sir. We were planning to get that done in time for the August hearing, for both this Commission and the Interstate Commerce Commission.

Q. You have prepared for this hearing what was required by the Interstate Commerce Commission for this particular property?

A. Yes, sir.

By Commissioner Bollen: It seems to me, Mr. Forbes, you could proceed to inquire into this for the purpose of the 1934 rate, and submit any data you desire to submit in connection with it.

Cross-examination:

By Mr. Forbes: Let the record show that the report of [fol. 66] the Northwestern Bell Company, in response to the Commission's order, setting forth quantities of the different classes of physical property, as shown by the ledgers of the company, and the annual rates of depreciation for the same, and also the annual composite rate for the depreciable property, and the statement showing the over all rate including all property, both depreciable and non-depreciable attached thereto, being a separate analysis consisting of several sheets of paper showing a separate analysis of each class of property, and the depreciation rate found for the same, which is offered in evidence by the Commission.

By Commissioner Bollen: It is received.

Which exhibit was duly received in evidence, marked Exhibit 1, and is in words and figures as follows:

[fols. 67-81] Exhibit 1 omitted. Printed side page 16, ante.

[fol. 82] By Mr. Forbes:

Q. Why is a depreciation reserve necessary, Mr. Granfield?

By Mr. Granfield:

A. Well, depreciation reserve is necessary, in my opinion, primarily to protect the property investment of the company, and it represents the amounts set aside to off-set the loss in property as it is used up in service.

Q. Wouldn't it be practical to charge depreciable plant to operating expenses.

A. I don't think it would, because the fluctuation would be so large that it would make the expenses vary widely from year to year, whereas when the property displacements are handled through a depreciation reserve, in accordance with straight line method of depreciation, the charges are spread out on a fairly even basis, so that there are not the violent fluctuations in expenses that would otherwise occur.

Q. You think it would make the earnings of the company fluctuate too widely to charge a realized depreciation annually to expenses?

A. Yes, sir. It would make the whole financial set-up fluctuate widely.

Q. You believe that if you charge a fixed sum to expenses, or rather an amount computed on the depreciable property, that you level out the income and equalize the annual earnings?

A. It levels out the expenses and prevents fluctuation from that cause in the annual net income.

Q. Wouldn't it be better to charge the exact amount of realized depreciation than to estimate an amount you may need?

[fol. 83] A. You mean to charge each year the amounts actually realized that year from plant displaced, instead of charging an average amount, is that your question?

Q. Yes.

A. That would not be practical in a telephone company, particularly a telephone company which has any growth. For instance, if you started out with a single exchange, with the property all new today, you would have relatively insignificant depreciation expense realized during the first few years. Then there would come a period when the charges to depreciation would be very large, so large that the expenses might be easily doubled or trebled for several years in succession, and it would be very difficult for the company to recover its loss, if the accounting were handled on that basis, in my opinion.

Q. There is no such thing, is there, in your experience, as an absolutely new telephone property?

A. Not covering a large territory. We have had towns that have been burned out, by forest fires, and been replaced as of one date.

Q. The property of your company is now and has been ever since you have known it, of varying ages, from old to new?

A. Yes, sir.

Q. So the idea of starting with a new property wouldn't apply to your situation?

A. No, I just cited that to indicate the nature of the effect. We wouldn't have it in that extreme form in a going company, but the age of the various items of property [fol. 84] in a going plant, the age distribution as we call it, is subject to wide variation, and in setting up our depreciation rates, we give consideration to that factor. That is, we weight in, in effect, the amount of plant of the various ages. We don't assume there is any average age. The system of accounting for depreciation which we use, makes allowance for the fact that there is both old and new plant in service.

Q. In a property the size of your company, extending into several states, don't you find that you have average annual realized depreciation expense which runs fairly uniform?

A. No, I don't think that it does. You mean in percent or in dollars?

Q. The realized depreciation in dollars?

A. No. Some classes of plant, especially, are subject to a fairly wide fluctuation. For example, a year in which we have to replace two or three central offices, particularly if buildings are included, would show fairly substantial charges to the reserve for those accounts, whereas other years might have no experience of that kind reflected. Even in the pole line accounts, where one of the principal causes of retirement is just age, we have considerable fluctuation —years when there happens to be large highway programs in several parts of the territory, our displacement of poles might be double what they would be in some other years.

Q. You think then that your pole line property is subject to a wide variation in the cost of realized depreciation?

A. Yes, sir. I cited that because it is a class of plant that ordinarily would seem to have fairly constant retirements, because age is an important factor. But in spite

[fol. 85] of the stabilizing effect of the retirements due to age alone, there are still enough other factors that come in so that even with that type of plant, there is a wide fluctuation in the annual retirements.

Q. That would depend, to a large extent, on the policy of the company, would it not?

A. It might be influenced by policy, but if we have a pole line along a main highway, and they decide to widen that highway twenty-five or fifty feet, the pole line has to be removed, regardless of what our policy is. And the same way with an order to remove our poles from a certain street in the city, is something over which we have no control.

Q. You cited two instances where you have what might be called sudden depreciation on account of state or county regulations. How does that apply to the average exchange?

A. Well, I think now the conditions are such that there are not many locations where we are presently being ordered off of streets, but there are years when that is a fairly important item. A similar sort of thing comes up when it is found desirable or even necessary, to combine the electric light distribution systems and the telephone distribution systems on the same poles in a community.

Q. What are the principal factors in depreciation?

A. Speaking broadly, the principal factors are growth, public requirements, development in the art, and decay. Not necessarily in that order, but those are the factors.

Q. Which is the largest of those factors, if you know?

A. I think it would be difficult to answer that question. Certainly difficult to answer it with reference to all prop-
[fol. 86] erty. Even taking a single class of property, it is difficult to answer, because so much plant is retired from what might be described as a complication of causes. Sometimes a pole line, for instance, is not quite worn out, but it is old enough so that factor combined with some other factor, might bring about its retirement. We have never been able to definitely associate causes of retirement with individual items to make it practical to set up any analysis on that basis.

Q. I believe we understood in the past years that growth was the major factor of depreciation?

A. Growth is a very large factor. In some classes of plant it is more effective than others.

Q. That would be because of the change from one class of service to another?

A. It might. It might be a change to make available a larger capacity in the same class of service. For instance, a fifty pair cable to be replaced by a hundred pair, or a twenty-five foot pole line raised to make room for more crossarms.

Q. You have had, during the past twenty years, a good deal of depreciation, which was directly caused by growth, I presume?

A. Yes, we have, directly and indirectly both.

Q. Strike that, I want to change that twenty years to twelve years. That is where the capacity of the exchange had been increased, lines have been extended, capacity of equipment has been enlarged in general, switchboard, etc., changed from one class of service to another?

A. Yes, sir. We have had experience with all those factors.

Q. Also built new lines, and extended your farm lines, [fol. 87] and built new lines in the town portions of your exchanges?

A. Yes, sir. The extension of service, however, is not immediately reflected in retirements.

Q. But the rebuilding of lines to provide additional capacity—for instance, the substitution of fifty pair cable for twenty-five and the erection of additional wire on farm lines, and things of that sort, have caused depreciation due to growth?

A. Yes, sir. We have displaced some plant to make room for plant of more capacity. At the same time, we have had to extend the plant, as you mentioned, and these new extensions work the other way because it adds new plant from which there are relatively few retirements for several years.

Q. You have been passing through a period of development in this company since it became the Northwestern Bell Telephone Company in 1921?

A. Yes.

Q. And your depreciation reserve has grown almost continuously during that period?

A. It has grown in dollars, certainly, because the plant has increased in value.

Q. And your percentage of reserve to plant has also increased up to within the last year or so, has it not?

A. The change in the percentage, of course, hasn't been so wide as in dollars. I don't recall just what the trend has been. I think it has been up for a while, and then down, and then up. Not any very pronounced trend for the last seven or eight years.

Q. Do you anticipate that you will have the growth in the state and county, and municipal regulation in the future [fol. 88] that you have had?

A. You mean the growth in the immediate future compared to the growth in the immediate past, or how long a term do you have in mind?

Q. The next few years?

A. The next two years as compared with the last two?

Q. Well, the next five years compared with the last five.

A. I think it is well within the realm of probability that the next five might have as much growth as the last five, inasmuch as the last five included two or three lean years.

Q. Do you anticipate that you will be changing the class of service at many exchanges in the next few years?

A. I expect there will be some of that.

Q. Raising the class of service?

A. I don't know what you mean by raising, but there will be exchanges which will be found better adapted to a different type of service than they are to the type they are getting, for economical reasons. That is, I don't expect there is going to be any freezing of types of service in accordance with that now being given. There are always exchanges which are becoming adapted to different types of service and——

Q. I am trying to find out whether you think the demand on the reserve will be as great the next five or ten year period as they have during the last five or ten year period?

A. Related to the amount of investment, it may be that the demands on the reserve in the last ten years were somewhat more than would be expected in a normal decade, but my own opinion is that the tendency would be to overesti- [fol. 89] mate that difference, for several reasons. One reason is that a great deal of the plant retired in the last ten years was plant which was already old, and which had been placed at prices lower than we expect to ever place any other plant for.

Q. As a matter of fact, hasn't this state as a whole, having reference to Nebraska only, passed through a period of development in the last ten years which is behind, as far as depreciation is concerned, for a long while?

A. Not in all respects, in my opinion. Just as an example, I would expect that within the next ten years we would have possibly a toll cable all the way across Nebraska, taking the place of open wire line.

Q. Speaking now of toll or exchange?

A. That particular instance is toll. I think that will come as a matter of economy.

Q. Isn't it true that the towns in Nebraska from twenty-five hundred to five thousand, where you own exchanges, have just about experienced the growth that they will have for a long time?

A. I think that that may be generally true, if you are talking about rapid growth, but I am not familiar enough with the prospects of individual exchanges in Nebraska to answer that.

Q. In connection with this growth in these towns, isn't it true that they have done about all the paving which will ever be done or will be done for sometime? Your poles are in their streets and you have taken care of those changes in plant you have referred to?

A. I don't know about the paving situation in the towns [fol. 90] in Nebraska. I think there is always a possibility for extension of underground plant, at the request of city authorities. How far that's been carried in the smaller Nebraska towns, I am not qualified to say.

Q. Have you followed the growth of the towns in Nebraska in recent years?

A. Only in a general way. I know the over-all growth has been small. The telephone growth has been negative for a year or two.

Q. Isn't it true the towns in Nebraska have not grown in the last five or six years?

A. I think that is true.

Q. Is there anything makes you believe that they will?

A. No, I don't know of anything that would make me expect any large growth. On the other hand, I don't think that the population growth has been extremely rapid in the last ten years.

Q. Isn't it true that most of our towns have passed through the period of changes that were extensive, in a telephone plant?

A. Some of them have. There are towns that still are not on a joint construction basis with power companies; there are towns that have substantial portions of old plant that is wearing out.

Q. In the ordinary course of development of the telephone plant, where the switchboard is operating magneto, perhaps the farm lines are grounded, and the town portion of the exchange lines are metallic, the exchange has gone on, the farm lines have been made metallic, the town has been cabled, the switchboard been made common battery, [fol. 91] isn't that about the maximum development as far as we know now in towns around twenty-five hundred to five thousand inhabitants?

A. When that has all been done, that is about as far as we expect most of them to go now. However, there are constantly being made new developments in service. It is now possible to handle even grounded lines through automatic switching equipment, whereas even two or three years ago it was impractical to use automatic switching equipment where any grounded lines were involved, and that precluded a change being made that might otherwise have been desirable. Also, the extent to which grounded lines are used is still considerable in Nebraska.

Q. Do you have reference to your company only in speaking——

A. And exchanges which we serve have many grounded lines, which we do not own, but we do provide service.

Q. I want to confine the discussion to the property owned by the Northwestern Bell Telephone Company?

A. I don't know off-hand the mileage of grounded line.

Q. It has never been the policy of the company, has it, to build a grounded circuit?

A. Not for many years. There will not be many new ones to amount to anything. I am sure of that.

Q. And after you acquire an exchange, you almost immediately make the exchange metallic.

A. Yes, sir. But not always the farm lines.

Q. The reference of change from grounded to metallic wouldn't apply to your company?

A. Wouldn't be a large item, no. It is not a large item in depreciation. When we make a grounded line metallic, [fol. 92] we merely add another wire and while that tends probably to reduce the average service life of the two wires considered together, it wouldn't result in large displacements.

Q. Is automatic service the only thing you see in the way of new development in the telephone field?

A. That is a pretty large question. There are developments under way relating to toll cables, to all kinds of switchboard equipment, both automatic and manually operated, and telephone instruments. In fact nearly everything we use is under investigation most of the time with improvement in view.

Q. Let's get down to brass tacks. These hand-sets is the only thing that's come into the telephone for a long time?

A. That is a substantial change in form, but there are different types of hand-sets under investigation. Some of the manufacturers I believe have already marketed a hand-set which includes the bell box and everything in the base instead of having in a separate box.

Q. Would you say you needed a large reserve because you expect to make all the exchanges in Nebraska operate automatically?

A. I didn't quite get the question.

Q. Would you say you needed a large depreciation reserve because you expect to make all you exchanges operate automatically, with automatic equipment?

A. In the first place I am not sure we expect anything of that kind, and the depreciation reserve is set up on the expectancy of each class of plant, and has not been increased in anticipation of any sudden change in type or service any place.

Q. Beginning on that proposition, your reserve has in- [fol. 93] creased almost steadily since the Northwestern Company was organized in 1921, to a point where it is approximately 25% of your fixed investment, has it not?

A. It is about that percentage. I don't think the present percentage is the maximum it has been. I think it has been a little higher.

Q. What explanation do you offer for the necessity of a 25% reserve?

A. The reserve is intended to represent the cost of the property, the part of the cost of the property now in service which has been used up, on the straight line theory. That reserve for a company might be anything from a low percentage for a plant which is nearly all new, to a very high percentage for a plant which included many old elements. At a time when your plant is not being added to very much, your reserve, if your accounting is correct, will nearly always increase in percentage, because your plant is steadily growing older and you haven't very much new plant coming in to reduce the average age. A simple example is, if you own say one automobile and were setting up a depreciation reserve for it on the expectancy of say a five year life, and zero salvage, in the fourth year you would have set up 80% reserve. If you had several automobiles of different ages, the reserve you would have at any time would depend on the number of cars that were almost ready to retire in relation to the number that were relatively new and required very little reserve. In a telephone property it is the same sort of a problem, but complicated by the fact that there are an infinite number of [fol. 94] items having different life expectancies and different present ages. To justify the reserve, and as you know that is contemplated in the I. C. C.'s order, it is necessary to make a very careful study of the age distribution of the plant now in service, and relate that to the life expectancy for each class of plant determined from the depreciation studies. From those factors, a calculation can be set up which will, within relatively narrow limits, indicate what the size of reserve should be for a given company. That calculation is being carried on for the Northwestern Company and I believe is expected to be filed with the Interstate Commerce Commission sometime next year. I don't recall the date.

Q. You have approximately a hundred and twenty-one million dollars depreciable plant spread over four states. Isn't it true that you are replacing property every day?

A. Yes, sir.

Q. Isn't it true your plant is not a new plant—it's been operating for years and you have reached what you might call a normal replacement experience? That is, you are replacing a certain amount of property each year, year after year?

A. It is not uniform year by year tho.

Q. But you are replacing it in various amounts as you go along?

A. Yes, sir.

Q. Your age is not going up, as time goes by, the average age of plant?

A. I am not sure what the trend in average age has been. The average age of the plant I think tended to decrease during the period from 1920 to 1930. The last two or three years the average age has probably been increasing be-
[fol. 95] cause there have not been large additions.

Q. I am wondering why you consider twenty-five million dollars reserve necessary, if that is the correct figure.

A. Well, as I stated, we expect to have definite calculations supporting that in detail. It is quite a lengthy research job but it is supported by general knowledge of the plants. (Comparatively speaking, the Northwestern Company has not been a rapidly growing company. The growth in this territory has been on the average small telephone growth. Exchange growth probably hasn't averaged 2% per year.) So that there is always a substantial amount of old plant on the books in relation to the amount of new plant, and with old plant your reserve requirements are much higher. We might take as an analogy an insurance company. I don't think that any insurance company ever feels that because they have been in business for many years, that their age distribution of the risks has got to a point where it is considered stable enough so that they can take the annual actual mortality losses and assume that is all they have to be prepared to meet. We attempt to do the same thing—to bear in mind that we have some property which has a much lower life expectancy than the remainder, and the reserve must be adequate to meet the retirement of this property having relatively short expectancy, just as much as it has to meet the retirement of the new plant.

Q. Can you think of any changes in the art—can you think of any changes in conditions of a telephone industry, which might make it necessary to use your twenty-five million dollar reserve?

A. You mean an emergency that would use it immediately?

[fol. 96] Q. Yes.

A. No, and there is no element of any such risk considered in setting up the reserve. That reserve is not expected to be required over night to meet some calamity or sudden unanticipated retirement of property. It is merely intended to cover the retirement of existing property when it reaches the point where it is normally expected to be retired. For example, to return to the insurance analogy, if the insurance company had a large number of twenty-five year old risks, and a small number of fifty or sixty year old risks, their reserve would be much lower, and should be much lower, than a company having a large number of older risks and a small number of younger risks. Without knowing the age distribution of telephone property, it is, in my opinion, impossible to draw any conclusions with respect to the size of the reserve, except that it should be less than one hundred. Without knowing the age distribution, you can't fix it closely.

Q. As a matter of fact from 1921 up to 1927 or 1928, approximately, your reserve grew quite rapidly, did it not?

A. I think that is correct. I don't recall the exact trend of that.

Q. Finally it reached a point of approximately twenty-five or six million dollars. Now I am trying to find out what you think could happen to your plant as the years go by, and taking into consideration the fact that you credit the reserve annually with about five million dollars and your realized depreciation costs you about the same, I am trying to find out what you can see in the future that is going to require the use of that reserve?

[fol. 97] A. We have the retirement of a large amount of valuable property which is bound to take place in the future. For example, we have a large building in Omaha. We haven't retired any of it. We know at some time we are going to retire all of it, and we have to have money accrued, so that when it is retired, we will have accrued just the amount it cost us. Now, until we have retired all of the investment in long-life property, our reserve will have to be much larger than is required to meet the current retirements that are experienced in a two or three year period, or even a five or ten year period.

Q. Does your company own any other buildings in any of these states besides the Omaha building?

A. Yes. We have a building in Des Moines, and Minneapolis. They represent as much investment as the Omaha building.

Q. Do you have any other such buildings in Nebraska besides the Omaha building?

A. No. We have no other exchange in Nebraska that approaches Omaha in size.

Q. Then you would only have two such buildings in your system, besides the Omaha building?

A. I think that is right. We have buildings that approach those, but are not quite so large.

By Mr. Randall:

Q. You said it was the purpose to accrue the cost of these buildings. You mean the cost less salvage?

A. Less any salvage that may be realized, yes, sir.

By Mr. Forbes:

Q. Would you say then that reserve was necessary on [fol. 98] account of these three buildings?

A. No, I wouldn't say that it was. Those were merely illustrative examples of property representing a large investment and today having had no retirements against them. Other examples are underground conduit, of which we have retired relatively small amounts; treated pole line plant, which is relatively new and represents a large investment, and the retirements against treated pole plant today have not been at the rate they will be when the average age of that plant gets higher.

Q. Your composite rate for depreciation has been going down?

A. Yes, sir. It has gone down rather steadily for the last seven or eight years at least.

Q. During the period you have had the changes as a result of the development of the telephone business in Nebraska, you use the higher rate?

A. Prior to the changes, we used a higher rate. Very often the changes tended to lower the rate, because the new property which went on the books took a lower rate than the old property which it displaced.

Q. In connection with that, you are using a better class of property than you did, are you not?

A. Yes, I think that is true.

Q. The lives of your poles are longer than they used to be, are they not?

A. We expect longer life.

Q. Is that also true of any other part of your property?

A. Yes. You will notice on the schedule of rates that our dial central office equipment takes a lower depreciation rate than the manual, which it replaced.

[fol. 99] Q. There have been improvements in cable, have there not?

A. Yes, there have been improvements in cable. Of course when you get into cable improvements, that may very well progress to a point where they bring about rapid retirement of open wire.

Q. But the life of cable itself has increased considerably, hasn't it, in the last ten years?

A. Yes. There have been several factors in that—partly in cable itself, and partly the improvements in distribution systems—more stable plant generally.

Q. Then we have cable, poles—how about iron wire?

A. Iron wire improvements. Improvements in the wire, from a physical standpoint, might very well be off-set by higher transmission requirements, which may tend to displace any iron wire from some classes of service.

Q. Would the life of your sub-sets be any longer than it used to be?

A. Well, the depreciation rate for sub-sets is based on the life in one location, and of course the business depression such as we have been going through, tends to shorten that.

Q. How about switchboards, outside of automatic?

A. Switchboard- are rarely retired because of wear and tear. They are kept up to practically a hundred percent condition by current maintenance charged to expense.

Q. Is the switchboard you install now a longer lived piece of equipment than it used to be?

A. Not from the standpoint of physical durability, but it is hard to answer that question, because I think that switchboards while they could have given longer service under the conditions under which the present boards are placed, [fol. 100] they may be exposed to demands in the future that the present boards haven't experienced in their history. Speaking of manual boards.

Q. Growth is a big factor in the depreciation of switchboards, isn't it?

A. Growth has been the major factor in the past. I would'nt be at all surprised if developments in the art were a paramount factor in the future.

Q. The life of telephone equipment and materials in general, have lengthened considerably in the last few years, has it not?

A. That is true. At the same time, there have been introduced into the plant some elements that were never there before, such as telephone repeaters and dial equipment, and some of these new elements will probably have a shorter life than the average of all property, because they are new and the first years of experience tend to bring about improvements and modifications.

Q. The major items then have been made to live longer through improvements in materials?

A. That is true.

Q. And manufacturing?

A. Yes. That is illustrated for example in our pole depreciation rate. You will notice that the depreciation rate for the newer treated poles is lower than our rate applied to the old poles.

Q. In the early days in this industry, they used to use poles without any treatment, did they not?

A. They did.

Q. Fifteen or twenty years ago they used to use untreated poles?

A. Yes, sir.

Q. What are they installing now?

A. Poles we are installing now are either cedar poles which are butt treated by a process known as a penetration [fol. 101] process, which drives the creosote used for treatment a half inch or more into the wood, or else we are using creosoted pine poles which are treated throughout their entire length in a tank of creosote.

Q. What would you say it increased the average life of the pole, on account of treatment?

A. The average increase in the service life of poles, as a result of treatment, is expected to be about eight years.

Q. How many?

A. Eight years. The treatment by itself—the effect of the treatment by itself will probably be somewhat longer

than that, but the fact that the pole is standing in the line for that much longer time, means that there are more chances for it being retired from other reasons. We can't hope to get an extension of life on the average equal to the full length of time for which the treatment is effective.

Q. Now, in accumulating the data which you have set forth here, you have considered your past experience?

A. Yes, sir.

Q. I suppose in the different classes of property you have gone back to different periods and times?

A. Yes, sir. We have gone back to poles that were set back in the nineties, I believe, and traced them through their life history.

Q. On Page 2 of Exhibit 1, I note that you do not depreciate organization. Am I correct about that?

A. I think so, but that is an accounting matter. I am not sure about the reasons back of that.

Q. You haven't pretended——

[fol. 102] A. No. We have set up no depreciation rate for it.

Q. You haven't depreciated land?

A. No, sir. We have no rate for land.

Q. And I'll inquire relative to the other items shown there?

A. I can tell you that we have not depreciated them. I misunderstood your question to start with. I thought you wanted to know what our reason was for leaving them out. I know they have been left out.

Q. Why do you leave out station installations?

A. Station installations are handled as an expense, because they have a short life, and the volume year by year is not subject to as wide a fluctuation as in some other classes of plant, and as a matter of accounting it was much simpler to handle them that way.

Q. You haven't included drop and block wires?

A. No. They are handled on substantially the same basis as inside wires.

Q. Charged to expense?

A. Yes.

Q. Beginning with Page 1 of Exhibit 1, I'll ask you what right-of-way is and why is it depreciated?

A. Right-of-way. Investment in right-of-way represents the cost of easements and permits of other types to place

property—telephone property, on privately owned real estate. Nearly all of the investment represents the cost of permits for placing poles on private property. For example, lines may go through a city block which has no alley, and to place our poles on the line going through the block, [fol. 103] we have to get permission from the landowners and frequently pay, usually a nominal sum of money for that privilege.

Q. That is money actually paid for the privilege of placing poles on private property?

A. Yes. That is what the principal part of this investment is made up of. The cost of acquiring that permit, the cost of the time and expense of the man who actually secures the right is supposed to be in that account, but in most cases, up until recent years, that probably was not capitalized in the Northwestern Company.

Q. Do you anticipate that you will lose your right-of-way? Why do you amortize the expense?

A. Because we abandon right-of-way. That is, very often the reason for which the right-of-way was secured disappears, and wherever possible in reconstructing lines, the new plant is taken off the private property. The matter of accounting for individual items of right-of-way would be so complicated that the retirement is now handled on an average basis. Every time a pole is taken off of private right-of-way and a new pole not placed there, an average amount is taken out of the right-of-way account, and that practice has been followed for the last three or four years, so that we have so far only a relatively small amount of experience as to the time it would take to turn over our investment in right-of-way under this accounting method. But from the indications in the last few years experience, when the activities have been way below normal, we were able to form a judgment as to how long we would ordinarily have right-of-way investment in use. Another factor is [fol. 104] that we have some right-of-way along railroad property, and there are several disadvantages in that, and ultimately I expect we will get away from railroads as much as we can. That will mean that that right-of-way will be abandoned.

Q. I take it most of this item applies to toll pole lines?

A. It is separated on the sheet. I think it is. Yes, very much more toll than exchange.

Q. When you buy right-of-way for a pole on private property in connection with an exchange, let's say in a residence district, you buy a permanent easement?

A. Sometimes, and sometimes it is merely what they call a revocable permit. I think most all of our right-of-way in additions is obtained from the man who lays out the addition, and is in the form of an easement. If we want to place a couple of poles on some private property, in order to get a drop into some subscribers premises, those permits have been what we call revocable permits. I think the present practice is to have few of them.

Q. What is the policy of the company, to buy a permanent easement or rent it annually, or how do you do it?

A. If it were rented annually, there would be no investment represented. We have some of those. But the policy, for lines of any importance, is to get an easement. Sometimes it is not possible to get one. What the company wants is an assurance that they will not be disturbed in their occupancy of that property, and they get as good assurance as they can at a reasonable price.

Q. Then your easement is permanent, and as long as you care to maintain a pole in any one position, it is your right to do so?

[fol. 105] A. Yes, sir.

Q. You find, tho, that you do move poles away from locations, and that is the purpose of this rate of depreciation?

A. Yes, sir.

Q. You may tell me how you arrived at 2.6% for right-of-way.

A. We arrived at that rate by compositing the rates for toll and for exchange right-of-way. We arrived at the toll and exchange rates respectively, by estimating the service life which we might expect from them and assuming no salvage. We estimated the service life at thirty years for exchange right-of-way which, with no salvage would mean a rate of 3.3%. And we estimated the service life of forty years and no salvage for the toll right-of-way.

Q. Did you consider private right-of-way in connection with exchanges, that is, individual locations, private locations? Did you consider those in connection with toll, and make one calculation?

A. No. The accounting procedure which we are now following, and which I described to you, has exchange right-of-way set up separately from toll, and when an exchange poll is retired and not replaced, there is a charge made against exchange right-of-way, and toll is also done the same way, separately, so that the records for the two classes of right-of-way are separate. We combine them here because there is just one primary account for right-of-way.

Q. What do you do with land. You don't depreciate land?

A. No. We have no depreciation rate for land.

Q. If you buy a piece of land you would show what you paid for it?

A. Yes, sir.

[fol. 106] Q. If you sell it later at a profit, what do you do with the difference?

A. My impression is that that goes to surplus. I am not certain of that. The accounting people can tell you that.

By Mr. Forbes: May we have Mr. Baird sworn now, so I may ask him some questions at this point.

Mr. R. P. Baird, being first duly sworn to tell the truth, the whole truth, and nothing but the truth, testified as follows:

By Mr. Forbes:

Q. I'll ask you the question, Mr. Baird. If a piece of land is purchased by your company and later sold at a profit, how do you take care of the difference in the accounts?

By Mr. Baird:

A. It goes to surplus.

Q. If there is a loss in the transaction, it is charged to surplus?

A. Charged to surplus.

Q. What is the experience of your company, as far as you know, with reference to the purchase of land?

A. As to profit and loss?

Q. Yes.

A. Generally loss. That is, it comes about by our discontinuing the use of certain exchange buildings, and the land and the building, when it comes on the market, is disposed of for whatever amount we can get for it, and gen- [fol. 107] erally involves a loss on both land and buildings. I don't recall whether the land element alone has been sold at a loss or not.

Q. On that proposition, if you buy a building or a piece of land, you buy the building and the land, you immediately separate them for accounting purposes, do you not?

A. We do, yes.

Q. And you put the building in the building account, and the land in the land account?

A. Yes.

Q. On the basis of the division which you consider proper at that time?

A. That's right.

Q. What does your land account show then by itself when you purchased land and sold it, either at a profit or loss?

A. The same price generally includes both land and buildings, and I don't recall any case where we have established a sale price for the land itself, so I don't know whether the land was sold at a profit or loss, but the total of both the building and the land shows a loss as contrasted to the combined book account.

Q. You think in most of your cases you sell the building and land together?

A. That's right.

Q. Why would you handle that through the surplus account?

A. That is the provision in the System of Accounts for handling such transactions.

Q. Does that meet with your approval?

A. Yes, I think that's o. k.

[fol. 108] Q. Now as to buildings, Mr. Granfield, you found 2.6% depreciation?

By Mr. Granfield:

A. That rate was arrived at——

Q. By making a survey of each individual building and getting the judgment of the engineers making the plans for it——

A. Including that building, getting their judgment as to when it would be retired from service, what would be the latest date which we could reasonably expect to keep that building in service, and also we obtained forecasts of dates as of which there would be retirements of substantial parts of the buildings, such as elevator systems, or substantial additions to the buildings. Using those data we arrived at an average service life, the weighted average, for each class of buildings which we have. Those service lives for the classes were then composited for all classes. There is also included there an amount of depreciation expense for an account known as improvements to leased buildings. That class of property takes a relatively high rate, because the practice is to accrue the depreciation over the duration of the lease. When the lease expires at a certain date, the cost of that improvement made by the telephone company to the leased property is accrued during the term of the lease, and if the lease is renewed, there would of course be no depreciation in the second term of the lease.

By Mr. Peycke:

Q. That's a very small item, isn't it?

A. Very small, but the rate for that part of the account is high.

[fol. 109] By Mr. Forbes:

Q. Then, as I understand you, you didn't arrive at this rate of 2.6% because the building had come to the end of its life in your possession?

A. Based on forecasts rather then experience.

Q. What you did was to approach the building, and know that it was built in a certain year perhaps, we'll say twenty years of its life had expired, and you estimated that it would last twenty years more?

A. That's the process.

Q. But you didn't have experience enough to determine this rate from the actual depreciation of the building?

A. No. The reason for that, of course, is that the service life estimated for some of these buildings covers more years than the telephone has been in service, and the buildings which we have retired, and we have retired quite a number of buildings, are not directly comparable with many

of the buildings we now have. We have retired quite a few buildings in Omaha, but none of them are comparable with the building we now have, either in investment or in life. So we were compelled to make forecasts in the light of all the knowledge we could get about the conditions surrounding each individual building.

Q. Then this is really a matter of judgment?

A. Yes, sir.

Q. Based on the fact that you know the approximate age of the building?

A. Yes, and we know something about the experience with similar buildings in other uses. Some of our buildings are in a way comparable to the types of buildings which [fol. 110] have been constructed in some of the larger cities in the country for thirty or forty years back, so we get some information from that.

Q. If you should look at the building and decide you might like to install a larger switchboard, but needed additional facilities, then you probably would decide the building had a short life?

A. Yes, sir. For instance, if we had a building housing manual equipment, and indications were that that equipment would have to be replaced within say ten years, if that building were not of a type which could house the newer equipment, and did not also have enough spare space in it so we could put the new equipment in without taking the old out, that would mean we would be compelled to erect another building at the time we changed the service. Those forecasts are fairly definite, of course.

Q. Did you make any of those forecasts in arriving at this 2.6%?

A. Were there any buildings of that type? I believe there were in some parts of the territory. I don't recall any in Nebraska.

Q. And by the way, this question applies to all your data here. You gathered data from Nebraska and Iowa and Minnesota and South Dakota?

A. And North Dakota. Both Dakotas. Yes, sir.

Q. So in considering the changes, you not only considered what might be the prospect in Nebraska, but you have considered the plant in all these states?

A. Yes, sir. That is, we considered every building we owned.

Q. Then really, as to the life of this building, that depended on what your inspector thought, to some extent any way, about the prospects for increased use of the building or increased capacity being required?

[fol. 111] A. Yes, or such things as shift of population—shifting of office centers.

Q. If he decided they might, in a few years, need a larger office or a smaller one, he would fix the life of this building on the basis of what he thought might take place?

A. Yes.

Q. Then this really isn't a fact, that you determine the annual rate of depreciation on account of wear and tear?

A. No, sir. Wear and tear probably will not be a large factor in most of our building retirements.

Q. Largely a matter of judgment?

A. Yes, sir.

Q. At the time you look it over, with connection with what you estimate, the company might care to continue with that particular exchange?

A. Yes, sir, and in some cases it involves forecasting so far in the future that it is beyond any immediate programs that the company might have. For example, a building built today and expected to last fifty years, would obviously be beyond any detailed program that we might have.

Q. Was any of this information based on experience, with reference to buildings?

A. Only that the judgment exercised is influenced by experience, and we have records of all of our experience. For instance, we have right now a half dozen buildings that have been recently retired, and our experience with them has had a direct bearing on our estimate of salvage, because we know, from our experience in disposing of those buildings, what the probable salvage might be.

[fol. 112] Q. You did consider the salvage on the buildings if actually wrecked, or the salvage on the building you had still?

A. More as a back-ground than as a measure.

Q. Did you consider all the buildings the company owned when you made up this calculation?

A. Yes, sir.

Q. Went around and just estimated the life of each building, in connection with the telephone requirements?

A. Yes, sir. We considered each building and the probable history forecast.

Q. Who does this estimating? Did you do it?

A. Not directly. We have in each of our engineering organizations a building and equipment engineer, and a plant extension engineer. The plant extension engineer's function is to determine future requirements, and the most economical way of providing for those future requirements, and he in turn gets much of his information on which he basis his plans from commercial surveys made by the commercial department to determine what the prospects of the community are, its growth and population and telephone use, changes in character of the community, and in getting the estimate of probable service life of these buildings in a state, we conferred with the building engineer and the plant extension engineer. They reviewed the facts in the light of all they knew about it. Then we discussed it with them on the basis of the general considerations and such information as we got from other corresponding structures bringing about building retirement, and from those conferences we arrived at the forecast for each building in each area.

[fol. 113] Q. You didn't distinguish here between buildings constructed of different kinds of materials?

A. The supporting data which we are preparing is much more detailed in that respect. We have our buildings grouped, not by kinds of material, but by types of use. That is, we have large dial buildings and large manual buildings, so we have them grouped, but not directly by types of materials, but automatically, when we got down to small offices, we include a large number of frame buildings. Nearly all of the large buildings are of fire resisting modern construction.

Q. Has this rate you have used here for buildings been used for some time, or is it a new rate?

A. The building rate has changed within rather narrow limits during the past several years, the principal reasons for which have been erection of new buildings, and that would affect the composite. The rates that we have used for the last several years have been reviewed annually, and minor changes made, in one direction or another, as more information has been available, or prospects seem to be different. The building rate, I think, went up slightly as a

result of taking in as a separate sub-account, these improvements to leased buildings, which have a very high rate. I think that made a difference between 2.5 and 2.6 although it was a small matter, about one-tenth of a percent difference in the rate.

Q. What annual rate have you used for buildings in previous years?

A. My recollection is it was 2.5 last year, and I think prior to that it had been 2.6. It's fluctuated slightly, not due to any change in policy, but just to changes that come [fol. 114] about from making a composite each year, considering retirements and additions and occasionally a change in forecast. And there have not been large changes.

At this point noon recess was called, after which the taking of testimony was resumed at 1:30 o'clock, as follows:

By Mr. Forbes:

Q. Do you have any idea, Mr. Granfield, of the relationship or ratio between the buildings which actually depreciated to the limit of their useful value in the possession of the company, as compared to the total?

A. You mean investment in buildings we have already disposed of compared to what we have now?

Q. Yes.

A. It would be relatively small—the big investment we still have with us—we could give the exact figures, but I don't have them in my mind.

Q. Could you indicate what you would consider to be a fair percentage of buildings which you determine depreciation from actual experience as compared with your estimate basis which you appear to have used?

A. We use the estimate basis for all the buildings which we now have, and the buildings which we have retired do not figure in the result, except insofar as the information we get from that history helps our judgment with respect to the buildings we now have.

Q. Could you say then what the investment in buildings [fol. 115] was that you used that served their useful life for telephone purposes, as compared with the estimate of buildings that have not served their useful life, that were included in this calculation?

A. The calculation in this set-up here is based entirely on buildings which are now in service. They have not yet lived their life. We have the results, merely as a matter of information, with respect to the buildings which have already been retired, and the volume of retirements in investment of buildings which have been retired, I would guess at less than 20% of what we have now—substantially less.

Q. Would it be fair to say, Mr. Granfield, that this rate for depreciation is based on 20% experience and 80% judgment?

A. That would depend on interpretation, and your interpretation might be it's all judgment, because the buildings that are gone, we use that experience merely as a background, and don't bring it into the figures for the future at all, except as background.

By Mr. Forbes: I think that is all, Mr. Commissioner on that subject.

By Commissioner Bollen:

Q. What years in the past did you determine this experience from?

A. For buildings?

Q. Yes.

A. Well, all of the retirements we have had since 1910, I am quite sure are in there, and that might include buildings going back into the nineties, as far as construction is concerned, and of course all the buildings we have now, no matter when they were built, are included. Some of [fol. 116] those buildings were built quite a few years ago.

Q. During the past ten years, prior to 1930, is it not a fact that you were a growing concern?

A. Yes, sir.

Q. And might it not be assumed that because of that fact you had an excessive amount of replacements on buildings?

A. In the past ten years?

Q. Prior to 1930?

A. I think as it happened that our building retirements since 1930 would make the rate for those three years about as high as it was for the preceding ten. However, the growth did bring about retirements during that period.

Q. You have already told us what the factors are, in general, that make up a depreciation rate. What are the factors on buildings?

A. Buildings are retired for the following reasons: When equipment in an existing building is inadequate, for any reason, and has to be replaced, it is sometimes necessary and frequently more economical, to build a new building for the new equipment. When the wire center of a city shifts, as development or growth changes the center from which it is most economical to serve all subscribers, it is frequently economical to build a new building approximately at the new center, and abandon the old one.

Q. Well, is decay a factor?

A. Generally speaking, decay is not a factor. Certainly not in the buildings which represent the biggest investment.

Q. Well, a building does decay, doesn't it?

A. Well, the so-called fire resisting buildings, made of [fol. 117] steel and concrete, decay so slowly that in nearly all cases their useful life will be terminated by reasons having nothing to do with decay.

Q. What, if any, percent would you estimate for decay on that kind of a building you have just described?

A. Well, I would say that the decay would not be a factor in our depreciation rate, because such parts as are subject to rapid decay would be replaced. For instance, the building might outlast two or three heating systems, and two or three plumbing systems, if it were economical to replace them.

Q. Do you consider it a factor in other than the buildings you have described?

A. In the smaller exchanges, where they have frame buildings, and brick, etc., the physical life of those buildings is much shorter and they might be expected to decay appreciably in twenty-five or thirty years, so that there might be a question as to whether it was economical to keep them in service.

Q. What estimated percent of decay would you use in those kinds of buildings?

A. You mean the rate of decay per year?

Q. Yes.

A. That wouldn't be a uniform rate, and we never have segregated decay from the other causes, because these factors are so blended that it is impossible to segregate them with any accuracy.

Q. Then I take it that the larger factor in depreciation on buildings is inadequacy or obsolescence?

A. Change in location. Inadequacy or necessity for changing location due to development of a community.

[fol. 118] And sometimes public requirements?

A. Public requirements occasionally. Of course you might interpret, I suppose, necessity in the building of a new center as public requirement, due to that fact.

Q. Outside of Omaha, do you own many of your own exchange buildings in Nebraska?

A. Yes, we own quite a few of them. Off-hand, I can think of several—North Platte, Grand Island, McCook, Sidney and there are a large number of small ones that I can't recall off-hand.

Q. And Fremont?

A. I am not sure whether we own the Fremont building or not. I think we do.

Q. Norfolk?

A. We own Norfolk—it's a new building.

Q. Isn't it a fact that most of the exchange buildings you own are in the larger cities, such as those you have just mentioned?

A. Yes. We own a higher proportion of buildings in the larger cities than we do in the smaller, but the total number of buildings in the smaller might amount up to a fairly substantial number, and still not be a large part of the investment.

Q. Then I take it, the larger part of your exchange buildings you do not own are in those smaller towns, say less than three thousand inhabitants?

A. Yes, sir.

Q. Is that true in the other states?

A. In some of these smaller communities we have a combination residence and operating quarters.

Q. Isn't it a fact that at the present time you have a sur-

[fol. 119] plus of building capacity?

A. I think at any time we would have space in buildings that would permit some growth by and large. Now, when most of our large buildings were new, the spare capacity would be at a maximum. However, it is only a relatively short time since we had to build an addition to the Omaha building.

Q. Well, can you expect as much demand for buildings in the next ten years as you have experienced in the past ten?

A. For new buildings?

Q. Yes.

A. Not in money. Perhaps in number of buildings, but not in money. There might be a lot of small exchanges that would get new buildings, but the amount of money wouldn't be so large.

Q. You have lost, in the last two or three years, a large percent of your stations in Omaha, business and residence and rural. That is true, isn't it?

A. Yes, sir.

Q. Until those are restored, will you in fact have any demand for new buildings for the placing of new equipment?

A. Not for the purpose of providing additional space, but we might have for reasons arising from leases being canceled, or new equipment being required which it would be undesirable to put in rented quarters.

Q. With the present economic situation which now exists, and which will exist as far as small towns are concerned, do you anticipate having any leases canceled?

A. I don't know of any reason for anticipating any substantial number of them.

[fol. 120] Q. Due to the fact that most of these owners are glad to have you remain indefinitely, at this time?

A. Perhaps at this time, but for a ten year period that might not be true.

Q. I notice that your Exhibit 1, Mr. Granfield covers the five states?

A. Yes, sir.

Q. Is the rate of depreciation the same in each state, if you know?

A. You mean do we apply the same rate?

Q. Yes.

A. Yes, sir, with one exception, which is noted in the set-up. The pole accounts have different rates in the northern part of the territory than they do in the southern.

Q. What is the cause of that?

A. There are several reasons. The primary reason is that poles in northern Minnesota and North Dakota do not decay as rapidly as they do further south. And together with that, we have much more wind-load and sleet-load in the southern states, so that when a pole does start to decay, it is more likely to fall.

Q. When you speak of souther-, you mean Iowa and Nebraska?

A. Iowa and Nebraska as compared to Minnesota and North Dakota.

Q. Is it your judgment that the depreciation rate on that class of property is greater in Iowa and Nebraska than in North Dakota and Minnesota?

A. Yes, sir, very much so in the past. It probably will not be quite so marked with the treated poles.

Q. Then if this depreciation study had been made on Nebraska properties, is it your judgment the rate would [fol. 121] show a slightly higher rate than the entire study?

A. On poles, yes, sir. We don't get the high wind and sleet storms so much in the north.

Q. I think you stated that the growth, obsolescence, public requirements, if any, make the larger factor in your depreciation?

A. For buildings?

Q. On plant investment of all kinds, generally?

A. Growth, public requirements and similar factors, yes, sir, they predominate.

Q. Do you anticipate any of those requirements for 1934?

A. Public requirements in 1934 may be fairly substantial, as a result of these various highway and other civic improvement projects. Just for example, we have quite a toll job going out of Omaha in connection with the Dodge Street project.

Q. With your present surplus, owing to loss of stations, will there be any demand, or should there be any growth in that during the next four or five years?

A. Not as much as usual. Growth may occur in telephone requirements without a corresponding growth in population, and there is always a factor of growth in a given section of town. For example, I think just a year ago, in one of the cities, there was quite a drift of population from one section of town to another, and facilities in the section to which they were moved were not adequate and required a small increase in cable plant. The story was that in this addition, for a long time the real estate prices had been very high, and they came down far enough so that more people took advantage of it.

Q. Isn't it a fact the larger part of this factor is due to [fol. 122] your Omaha exchange rather than your other property in Nebraska?

A. A large part of what.

Q. Of the factor of growth and meeting public requirements?

A. Not in percent, I wouldn't think.

Q. Well, has it been much of a factor in the small towns, smaller than McCook?

A. Yes. It is not very long since we installed quite a lot of plant at McCook which had practically outgrown its previous telephone plant.

Q. If you were required, as a matter of judgment and public demand, to furnish metallic service where you now have grounded service, would that be considered in your depreciation accounting?

A. It would insofar as it would have any effect, but most of those factors have been operating year in and year out, and unless there was quite a large change, it wouldn't show up for a period of years. The classes of plant most affected by those sorts of changes, are studied by a method which shows the trend very quickly, and we have taken into consideration the indications of that trend for the last three or four years in setting up these rates here.

Q. Isn't it a fact that you have had considerable expense during the past ten years in converting grounded service over to metallic?

A. Yes, sir. But it hasn't always involved, although in some cases it has, it hasn't always involved retiring a lot of plant before its time. Sometimes it is just added plant.

Q. That wouldn't have anything to do with depreciation?

A. Doesn't have the effect of raising the rate, no sir.

[fol. 123] Q. Isn't it a fact now that the larger part of your plant in Nebraska is metallic service?

A. The largest part, from an investment standpoint, undoubtedly is.

Q. What percent would you estimate in Nebraska properties?

A. A very small percent of our investment in Nebraska is devoted to grounded service. Might be less than 5% in dollars. In miles of line it would show up larger, of course.

Q. I think you stated that your present reserve was about twenty-five million dollars, was that correct?

A. Mr. Forbes gave that figure somewhere around there. I don't know the exact amount.

Q. What portion of that should be allocated to Nebraska properties?

A. I don't have that figure. It could be calculated, but I don't have it. We had but one depreciation reserve account for the entire company, and it hasn't been set up by states. There would have to be some sort of a separation made to approximate it.

Q. In 1933 how did the amount that you used for replacements compare with the amount you collected for that purpose?

A. I don't recall the total amount charged to reserve for retirements in 1933. It should have been quite a little less than the amount set up, because there are so many types of plant representing large investments which were not represented at all in retirements in 1933. That figure could be obtained quickly enough from the accounts, but I don't have it in my mind.

Q. What was your reserve, increased in 1933 over 1932, or decreased?

A. I think probably it increased slightly.

(Discussion off the record.)

[fol. 124] By Mr. Baird: The resrve for the company in the state was $1,621,000 during the year 1933, to a total of $32,534,000 at the end of 1933.

By Commissioner Bollen:

Q. What's the present percent condition of your Nebraska properties?

By Mr. Granfield:

A. I can't answer that off-hand. I think we submitted an estimate of that at that hearing last year, but I have forgotten what it was.

Q. Aren't you able to state approximately what it is now?

A. It would be approximately the same at it was then. I have forgotten what that figure was. It is quite a complicated thing to work out.

Q. You don't remember?

A. I don't remember, but it is in the record, I am quite sure, in that hearing last summer.

Q. It was an amount in excess of 90% wasn't it?

A. It might have been. I don't recall the figure. But that is physical condition.

Q. Should the depreciation collected, for reserve for depreciation, represent the condition of the property?

A. The physical condition? No, sir.

Q. Not necessarily physical, but the percent condition taking in all factors that you used in collecting it?

A. I don't think so.

Q. I wish you would explain why it shouldn't, or why it does not.

A. Because reserve for depreciation includes amounts ac- [fol. 125] crued to reimburse the company for property lost in connection with casualties of various kinds—developments of various kinds, and public requirements that have not yet taken place. We know on the average, over a period of years, we will lose a substantial amount of plant in sleet storms, but the condition of a pole line today is not at all affected by the fact that it may be destroyed next week in a sleet storm, but the loss must be anticipated never-the-less. It seems to me that an analogy would be, an insurance company might have a thousand perfectly healthy risks, and their premium rates would have in them an element to provide for death by accident and illness that hadn't yet developed, but in examining those men, they would all be considered good risks and eligible for insurance. But nevertheless, the insurance company could not afford to presume that every one of those men were going to live to the maximum age they would attain by old age alone.

Q. In fixing the percent for depreciation, don't you use all these factors?

A. You mean the percent for——

Q. Your depreciation reserve.

A. Depreciation reserve.

Q. Don't you use it?

A. All those casualties, and all those factors which affect the life expectancy of the property, yes, sir.

Q. And these hazards you have just mentioned?

A. Yes, sir. They are weighted in on the basis of our past experience.

Q. Then I don't understand why your percent, or your [fol. 126] depreciation reserve wouldn't reflect the exact percent condition, providing you haven't made any errors.

A. Well, the percent condition determined by an engineer in the field depends entirely on the present situation with respect to all of these factors. The engineer making the inspection obviously is bound by what he sees there now, and not by what he thinks may be there ten years from now. Whereas, in setting up this reserve account, which merely is an indication of the amounts that must be accrued in order that the investor's money in the property will be protected when the plant is retired, must make allowance for these future occurrences which are not visible today from an inspection, but the probability is known from past experience.

Q. If your engineer, or if you went out to inspect your property for the purpose of determining the percent condition, I assume you would consider the age of the respective classes of plant investment?

A. To some extent. It wouldn't be the governing factor.

Q. You would examine also the actual condition?

A. Yes, sir.

Q. And wouldn't you also take into consideration future public requirements?

A. Only those that were obviously imminent.

Q. Wouldn't you also take into consideration the factor of obsolescence?

A. Insofar as it was present, yes, sir. We very seldom find any obsolescence present, because usually at the time the plant is obsolete, it is removed, and wouldn't be giving service.

Q. What I want to know is would you take into considera- [fol. 127] tion the same factors in determining percent condition that you would use in determining a depreciation rate?

A. Yes, sir, except that from inspection you cannot take them into account any further than they have been reflected up to the present time. In setting up a reserve for the future, we have to take into account how much they are going to be reflected in the entire life of the property.

Q. Then your present depreciation reserve, I think you said of thirty-two million dollars for the system, would

not only represent the condition, the present condition of your property, but it would represent other elements?

A. It would represent the loss due to rot and decay, and also a provision for future causes of retirement which had not yet taken place.

Q. In other words, your depreciation reserve not only represents the present condition, physical condition of your property, but it represents some other elements that you don't know if they are ever going to be required?

A. Represents other elements we do know will be required, but haven't been required yet.

Q. How do you know that?

A. From experience. We know, for example, we are going to have poles hit by automobiles; we are going to have poles burned down; we are going to have pole lines wrecked by sleet storms, and we are going to have a lot of these things we always have. Only from experience, we don't know what poles they are going to hit. The same as an insurance company takes in only risks that are physically sound, but they know they are going to lose many [fol. 128] risks for causes that aren't apparent.

Q. Isn't there a part of that based on experience, and part on guess, as to what those factors are going to be?

A. We can measure the over-all effect of all causes bringing about retirement of plant in the past with a fair degree of accuracy, and we can have fairly accurate ideas as to the trend of the future with respect to the past, because these things go over a long term. And by making use of those two elements, we feel we can set up a depreciation rate that will pretty accurately measure the retirements of the plant that we now have.

Q. Your depreciation for reserve now, as I understand it, is about thirty-two million dollars. Where is that reserve? What is it?

A. Reserve is merely accounting entries. It doesn't represent a fund, or anything of that sort.

Q. Is part of it invested in plant?

A. I would say substantially all of it is invested in plant.

Q. Is there any of it invested in securities?

A. I would say not.

Q. Is there any of it in cash on hand?

A. I can't answer that question with complete accuracy, but I would say, in general, it is all in plant.

Q. Can your accountant tell us the percent of your depreciation reserve that is actually invested in plant?

A. I think the accounting people can tell how much that is.

Q. When you invest it in plant, you add that to the plant investment?

A. Yes, sir, all of our plant investment.

Q. Upon which you claim a fair return?

A. Yes, sir.

[fol. 129] Q. Would you be able to answer that question for the record, and make our story continuous here?

By Mr. Baird:

A. The question is what percent of the reserve is now invested in plant?

Q. Yes.

A. We didn't indicate on the assets side as to whether it is reserve or not. Looking at the balance sheet, however, you will find that it must be mostly in the plant, because there are no such sums in the other assets. There is no way to tag it. We didn't tag it.

Q. Could you state from examining, or refreshing your memory, about what percent of your present reserve is invested in plant?

A. I have no way of knowing, except that there are no items in the assets side that anywheres near approximate the amount of the depreciation reserve, except one item of investments and securities. We have thirty-two million in reserve, and our assets of a hundred and forty-eight million. There is a hundred and thirty million in plant. The only large items other than plant is the investments and securities and advances of twelve million nine hundred thousand, and twenty-five hundred thousand in receivibles, but how much is in one and how much in the other, I would have no way of knowing.

Q. But you would say a substantial part?

A. Substantial, yes.

Q. I think you claimed last spring you were getting less than a 3% return on investment. A reduction of your de-

[fol. 130] preciation rate wouldn't effect the rate at this time, would it?

By Mr. Granfield:

A. Not substantially.

Q. Just be a matter of bookkeeping? Transferring it from reserve over to surplus. Then a reduction of your depreciation rate for 1934 would in no way effect the rate?

A. A reduction in the depreciation rate would effect the figures put up on the records.

Q. Would transfer a little more over to the surplus account, wouldn't it?

A. You mean would make a little bit more available for earnings?

Q. Yes.

A. Wouldn't be any for surplus.

Q. You pay your earnings out of surplus?

A. If you look at it that way, yes.

Q. In fact you paid dividends out of surplus last year, did you not?

A. Yes, sir, so I understand.

By Commissioner Drake:

Q. In your Exhibit 1, your classifications are the classifications as set out by the Interstate Commerce Commission?

A. Yes, sir, as to primary accounts.

Q. There are twelve accounts?

A. I believe that is the number.

Q. And all the property which you consider is in those twelve accounts?

A. Yes, sir.

[fol. 131] (Discussion off the record.)

By Mr. Peycke:

Q. You use the term decay quite a few times. Do you mean to use that as indicating what facts or factors—deterioration?

A. Yes, sir. We sometimes use wear and tear, but most telephone property is not subject to wear and tear from use. The posts decay from the elements.

Q. But you include every physical element?

A. On everything that is a function in the decay.

(Discussion off the record.)

By Mr. Forbes:

Q. In answer to Mr. Bollen's questions, I understand now that you don't include fire and storm damage in your factors of depreciation?

A. Yes, sir, insofar as they have had any effect in the past, but in appraising property and going out and inspecting it, we don't discount the effect of fires that haven't yet occurred.

Q. Well, haven't you set up a separate reserve for fire?

A. No, sir.

Q. Don't you carry insurance on any of your buildings?

A. We have some properties insured, but any amounts we collect from insurance companies for fire are just credited to the depreciation reserve, and the depreciation rate is made up to cover losses from all causes.

Q. Then your cost of insurance is a charge to expenses?

A. Yes, sir. But the amount of insurance we carry, and [fol. 132] the amount of insurance premiums is not an important item.

Q. But if you do get anything from an insurance company in case of fire, you credit that to the reserve?

A. Yes, sir.

Q. We have asked a good many questions about property this morning. I neglected to ask you, up to now, whether you considered the figures that are on the books of the company as the cost of the property, in making your calculations?

A. The composite rates are based on the book figures. Where we derive percentage relationships for any given year, we frequently adjust the book figures to a common level, so as to eliminate any effect of price fluctuations, when we are after a percentage figure.

Q. I have reference more to the practice of the company in connection with their property that's been purchased. My understanding is that in the years past, the company has put the property on the books on an appraisal basis, if it has been purchased?

A. That is not true in all cases. Sometimes the property has been appraised and put on the books on an appraised basis, and other times it has been merged and the cost, as reflected by the original owner, is merely transferred to our books. In making our studies of service life and salvage, it has been our practice to eliminate a purchased prop-

erty, in order to avoid any distortion that might come in from that special transaction.

Q. That is, you didn't consider any property that's been purchased?

A. Not generally in determining service life, because we think the service life of that property might not be representative of our standard property.

[fol. 133] But you do apply the rate you find to purchased property the same as any other?

A. Yes, sir.

Q. Isn't it true that for a number of years the company had the practice of putting property on its books on an appraisal basis, and later on a rule of the Interstate Commerce Commission required that the property be put on the books of the company on the appraisal basis, or the cost, whichever was the less?

A. I remember that last regulation. I don't remember any transactions that took place before that. There may have been some, but I don't know.

Q. I'll ask Mr. Baird how long this rule has been in effect, that I referred to?

By Mr. Baird:

A. Well, the first system of accounts came out in 1913. I know from my own knowledge our accounting for purchased property has followed the system of accounts since 1913, and that system provided for putting purchased property on our books at structural value, unless that was higher than cost. I think that provision wasn't in the system.

(Discussion off the record.)

In the revised system of accounts there is a provision for that method, or alternative.

Q. Then as I understand it, your accounts now show the appraisal basis, so far as any property you purchased was concerned?

By Mr. Granfield:

[fol. 134] A. Not in all cases. In some cases they have been merged, in which case they would reflect the cost shown by the original owner's books.

Q. But you intend that these rates shall apply to the purchased property as well as the other property?

A. Yes, sir, at whatever amount they now stand on our books at.

Q. But you didn't consider those properties in arriving at your rates?

A. No. We considered them, in that we eliminated them to prevent any distortion. Of course the amounts involved in the life of the property now in question are insignificant.

Q. In reference to reserve. You have a reserve for right-of-way separate from your depreciation reserve, have you not?

A. No, sir. That is not my understanding. We have just one depreciation reserve, which is not subdivided by accounts.

Q. I will ask Mr. Baird what reserve the company has?

By Mr. Baird:

A. What reserve we have now?

Q. Yes.

A. The report you hand me is for the year ending December 31, 1932, and shows miscellaneous reserve and a reserve for amortization of intangible capital. Those are the only two.

Q. You have a reserve for uncollectible accounts?

A. Oh, yes, we have a reserve for uncollectibles. It doesn't appear as a separate item, but we have it.

Q. I will ask you now what reserves the company has?

A. At the present time?

Q. Yes.

[fol. 135] A. We have a reserve for uncollectible accounts; we have a depreciation reserve; a small amortization reserve, $392.00; and an item here called provident reserve of $69,000. Those are the only one I recall right now.

Q. There is a credit balance in uncollectible accounts?

A. We have a credit balance in our reserve for uncollectibles, yes, sir.

Q. And of course there is a credit in the depreciation reserve?

A. Right.

Q. Is there a credit balance in the reserve for intangible capital?

A. There was on February 28, 1934.

Q. You could continue the reserve plan indefinitely, could you not, to include maintenance as well?

A. You mean that we could handle maintenance by estimating some fixed amount per month, and crediting it to reserve?

Q. Yes.

A. It could be handled that way, yes, sir, but it is not permitted. We could do it as a matter of bookkeeping, yes, but it is not permitted under the system of accounts.

Q. But the tendency of your reserve is merely to equalize your annual operating expenses, is it not?

A. No. It has that effect, of course, but if you are speaking of depreciation reserve, it has other functions, far more important in my opinion than that, namely, to reflect in the expense accounts, in the proper accounting period, the expenses of the business, and if you merely attempted to equalize retirements, I don't see right off here how you would do that and still show a correct income statement, unless you follow the accounting method that we are using [fol. 136] now, or something similar to it.

Q. The credits to these various reserves are charged to operating expenses?

A. Credits to the depreciation reserve are charged to operating expenses for the most part. There are a few items that go to other accounts.

Q. Then there is a credit balance in each reserve?

A. Yes.

Q. Doesn't it have the effect of increasing operating expenses, wherever you carry an expense in a reserve in the manner that you have carried it, if there is a credit balance in the reserve?

A. In the first place we don't—by expense are you including depreciation?

Q. I am referring to all the reserves the company carries. If you charged your expenses in the amount credited to the reserve, and there is a credit balance in the reserve over and above the amount actually required, doesn't it have the effect of increasing operating expenses by reason of the credit?

A. I don't quite get the significance of your question, but the charge to operating expenses is, in our opinion, the correct amount of expenses incurred during that year. That's the intention. To get the actual amount in the ex-

pense account. If that is correct, the size of the reserve would have nothing to do with the size of that expense account.

Q. If the correct amount is charged to expenses, there would be no credit balance in the reserve?

A. Oh, I wouldn't say that. There would be, naturally, a credit balance in the reserve.

[fol. 137] Q. That's through the charge to the reserve account. In other words, if you charge your expenses each year, and credit to your intangible capital each year, a certain amount, and your intangible capital shows a credit balance, doesn't that indicate that for that year, at least, you have charged too much to expenses on that account?

A. No, not at all.

Q. Does it mean they will have that expense at some future time?

A. That is the intention of that accounting.

Q. Well, couldn't you set up a maintenance reserve, regardless of the rules of the I. C. C. for the moment, and handle maintenance in the same way?

A. We could, as a bookkeeping proposition, yes, if somebody will undertake to estimate what the amount should be.

Q. You may state in your own way Mr. Granfield, how you proceeded to find the rate of 5.2 fixed for annual depreciation of central office equipment?

By Mr. Granfield:

A. The central office equipment account includes quite a variety of installations, and in developing the depreciation rate, we have studied each class of installation separately. We have taken the large common battery offices in one group, dial offices in another group, magneto offices in another group, and so on. The manual offices, that is the large manual offices, have been studied by determining the average service life already realized for each office. To do that we found when it was first installed; how much was invested in it at that time, and we follow it through its history year by year, and record all of the charges against [fol. 138] the reserve in that office for partial displacements and all of the additions made. As a result of the additions and retirements in an office placed, for example, in 1915, some eighteen years ago, might today have an average service life of as much as seven or eight years, because new equipment

represents a substantial investment, and has a short life or low age at the present time, and that off-sets the longer age of the parts of the original installation that still remains. From that sort of study for each office, we determine the expectancy or the average life in relation to age. Then we get forecasts of the probable final retirements from every office, and from that determine the average length of time that these installations may be expected to live, from initial installation to final retirement, and that average over-all age we call it, related to the average service life that's built up on the average in that period of time, gives us the average service life for that class of equipment.

Similar methods are applied to other types of manual offices and the composite rate for all manual offices is developed.

Then we have to take into account the dial offices; and the service life expected in the dial offices is a matter largely of judgment. We have retired several complete dial installations but the dial offices that constitute the greater part of our present investment in dial offices, are different in many respects from those which have been retired, so that we have, as a matter of judgment, given them a substantially longer service life.

Then there is also a substantial investment in toll termi- [fol. 139] nal and telegraph equipment. That is mostly relatively new equipment—the repeaters, terminals, telegraph equipment of various kinds, and the service life of that part of the investment is based largely on judgment, because nearly all of our investment in that type of equipment is only six or seven years old at the most. And we also have a small investment in miscellaneous portable equipment. That includes what was formerly known as the other equipment in central office account. That is such things as rolling ladders, wire chiefs desks, etc., and that was studied by what we call a turn-over cycle method, when it was in a separate account, and we have used the results of that study for this portion of the central office equipment account.

Then all of these component rates were composited on the basis of the investment as of January 1st this year, and the result was 5.2%. I didn't mention the salvage.

The salvage is based on judgment related to our past experience. There was a time in the past when there was quite a field for reuse of large manual switchboard- which

were retired from service, but now there is practically no field for them, and the last several offices we have retired have netted but little salvage, so the salvage set-up is based on what seems to be the maximum that we could expect, in view of the present state of affairs. 5.2% was the composite result of the detailed treatment of each subdivision of the account and each individual study is quite a voluminous study, and the supporting data, when it is prepared, will have quite a volume of data and analyses for each subdivision of this account.

Q. How many large dial offices does your company have, such as you have included in your large dial classification? [fol. 140] A. Oh, I would say perhaps—you mean exchanges or offices?

Q. Offices.

A. Oh, I would say somewhere around twenty or twenty-five.

Q. Have you twenty or twenty-five as you have indicated, in all territory of the Northwestern Bell?

A. Yes, sir.

Q. Comprising this larger value of $14,896,000?

A. Yes, sir.

Q. Have you retired any of this equipment?

A. We have retired quite a little dial equipment.

Q. I am referring now to switchboards.

A. Yes, sir. We have retired some fairly substantial installations in Minneapolis and Sioux City.

Q. I want to ask you about that. Was the retirement in Minneapolis—was that because you purchased that property up there?

A. That was a large factor.

Q. That wouldn't have anything to do with depreciation, would it?

A. No, those results were not used as a basis for this rate. The life of that equipment was not the basis for this rate at all.

Q. You referred to it as a retirement?

A. It's been retired from our books.

Q. Been retired because you bought it and didn't have any use for it?

A. No, sir. It was used for quite a few years, and was retired in connection with providing for the development

of the exchange. The company consolidated its offices in one building, and things of that kind.

[fol. 141] Q. Your company owned the St. Paul exchange?

A. No, just the Minneapolis exchange. We do not own St. Paul.

Q. Then you purchased the St. Paul exchange?

A. No, sir. There was competition in Minneapolis, and we bought out the competing company, and there was some overlap of service and that was wiped out some years ago, but then in the later development of the exchange, some of this dial equipment which had been used for some years subsequent to the purchase, was displaced with later type of equipment.

Q. Have you had any retirement of large dial office equipment in your experience, on account of wear and tear and obsolescence?

A. No, sir. None of the dial offices which we have installed are old enough to be affected by that as yet.

Q. How did you arrive at this rate, then?

A. That service life of dial equipment was based largely on judgment, relating our judgment based on our knowledge of the times for the dial installation, to the experience that was at all comparable with manual equipment. We have not had any of our own dial installations long enough to retire them, so this figure is based on the judgment as to the average service life which will be realized when the dial installations are retired.

Q. Yes, but you took that from the retirement of parts of the board, and your replacement of a part here and there?

A. No, sir. We made a review of the various installations, and made estimates of approximate life that might be expected, and from that general review arrived at a service life of twenty-two years, based largely on judgment. It's longer than the service life for comparable manual offices, principally for the reason that most of our [fol. 142] large dial installations were made to replace manual offices which had already grown up to about their full capacity, so that the effect of piecemeal additions which we had added in our manual offices, would not be as large a factor in the dial which we now have, because the dial was installed after the office had developed to practically its full size. Considering all the factors of that kind, we

arrived at the answer of twenty-two years, which seemed to us the maximum, average service life which should be reasonably expected from the equipment we now have.

Q. Did you estimate that the dial equipment would become obsolete?

A. Consideration was given to the fact that development in dial equipment will affect the service life, and more particularly affect the salvage of the plant now in service.

Q. What did you anticipate was going to take the place of dial equipment?

A. We didn't anticipate anything in the way of new type of apparatus, but we do know that constant improvements are being made in dial equipment, along such lines as speeding up the connections, and having a better and more certain, or you might say more trouble-proof arrangement for picking up calls—to minimize the possibility of double connections that naturally are constantly going on, and that would affect both service life and salvage to some extent.

Q. I don't understand quite, yet, how you arrived at this life which you have here?

A. Twenty-two years? I say based on judgment, taking into consideration the service life that we experienced from [fol. 143] manual and the type of dial installations which we have, and the progress and development in the art, and all similar factors—just weighting them as a matter of judgment, and we concluded with twenty-two years as the average service life.

Q. Then because there had been improvements in the manual board, you assumed there was going to be improvements in dial?

A. There have been some already. We now have an office in Minneapolis which may be displaced, largely because a better type of switch is available for handling heavy volumes of business than was available at the time it was installed.

Q. Of course this depreciation of central office equipment also includes all toll equipment?

A. Yes, sir.

Q. Whatever there may be in the central office?

A. Yes, sir. We have a separate rate for toll terminal equipment, that is, repeaters and equipment used on toll circuits, and their life is shorter—they are subjected to other reasons for retirement than the exchange equipment.

Q. How did you arrive at your depreciation on manual boards?

A. Well, that was what we call an average realized life study which I touched on in brief a few minutes ago. We get the average realized age of all the manual equipment which we now have, in classes, and we brought that as a group, which shows the ratio between total age and average service life. Then we forecast the date of retirement of the boards we now have, and from this we determine what the average service life will be, if the over-all life is thirty years, for example, and that sort of a calculation is carried out for the three principal classes of manual boards.

[fol. 144] Q. Did you have the cost of very many boards, on which to base your judgment, on the annual depreciation?

A. Did we have the cost?

Q. Did you have the cost of very many manual boards, to be used as a basis?

A. All of our manual boards are in the study.

Q. Did you have the installation and retirement?

A. Yes, sir. No, not retirement for all of them—not final retirement.

Q. How many boards did you have retirement data on?

A. I don't recall off-hand, but I can get that for you. We have a tabulation by offices.

Q. You took boards that had been installed and removed, regardless of the reason why they might have been removed?

A. Yes, sir.

Q. No matter whether they were worn out, or for any reason that they might be removed from the central office?

A. Yes, sir.

Q. The average of those you used as the average life of the boards?

A. No, sir. The average life of the boards already retired is not used as a measure of average life to be expected from the boards we now have. For that reason, we based the average service life for the boards we now have on a forecast of the date when each of these boards will, in our best judgment, be retired, and that gives us a measure of the time from the first installation of the board to its final retirement. We apply to that figure the rela-

tionship based on our experience to date of average real-
[fol. 145] ized life of average service life to the over-all life, and applying that ratio to the over-all life, we get the average service life which we expect from the boards which we now have in service.

Q. Let's assume you are considering a board in an average town in Nebraska, having in mind a manual board, you find a board installed there with equipment capacity to serve that exchange. Let's assume further it is a common battery board. Did you make a study of that exchange to see what the demand might be on the switchboard?

A. Yes, sir. A forecast was made for that exchange, in conjunction with the engineer who would recommend a board for that exchange, to find out what the prospects for retirement of the present installation are.

Q. Then if the board had served five years in its location, or ten years as the case might be, you pretended to estimate how much longer the board would be there?

A. Yes, sir.

Q. In so doing you took into consideration all the physical and service features of the exchange?

A. Of the entire exchange, yes, and the community served, and its location with respect to toll centers, and all that sort of thing, and the building, whether quarters were suitable, etc.

Q. Then the life used here, that you have here on manual boards, seventeen years, is based on an estimate and experience?

A. Yes, sir.

Q. Can you say how much is estimate, and how much is experience? A. Why, not off-hand, but our figures will show definitely where we start projecting it. For instance, [fol. 146] we have a board now that was placed twenty years ago, and perhaps has an average realized age now of twelve years, the forecast of its final retirement might be within such narrow limits, that the average service life would be pretty definitely determined. On some of the boards, the future outlook is not so clear, but by and large, one of those will average out against another. We find that graphically representing the relation of average service life to total age, the curve begins to flatten out, after a certain period. You get to a point where even if your over-all age is off two or three years, it does not affect the aver-

age service life. The curve begins to flatten out, and your over-all age is not such a large factor.

Q. When you say that the curve begins to flatten out, I would like to know if that means that the board is going to stay on in its location indefinitely?

A. Not necessarily, but it means that after a certain period, that the ratio of total age to average service life will be about constant.

Q. Why did you estimate you would take the board out of plant, when you concluded to take it out?

A. What reasons?

A. Yes.

A. Oh, there are various reasons. In some cases it would be an estimate that the building would be inadequate for more than a certain number of years. In other cases the equipment would be inadequate or uneconomical as to type. In other cases it would be necessity for changing the site in connection with a possible reconstruction of the plant. There is no chief outstanding reason as applied to a great many boards.

[fol. 147] Q. Right at this point, unless a board had become badly worn and inadequate and obsolete, you wouldn't take it out, would you?

A. If I understand your question, we wouldn't take a board out if it were giving satisfactory service in all respects, and was so located we could continue it there, but if it is necessary for service improvements or for economy in operation, or for better quarters, we might and frequently have taken out boards that were in good physical condition, but not as suitable as something else for the same service.

Q. Now, Mr. Granfield, wouldn't it be good engineering to leave a board in its location as long as you could, and until operating economies would justify its removal, unless there was a demand on the part of the public for a different class of service, or an improved service?

A. Yes, sir, I think so.

Q. Wouldn't it be good engineering at all times to get as much of the wearing value out of the board as possible?

A. Yes, sir.

Q. You didn't figure, in coming to your conclusions, that these common battery boards would be replaced with dial equipment?

A. Not in all instances. In some instances where manual installations are known to be about ready for dial for various reasons—not very many in Nebraska.

Q. Did you consider that the dial is going to force the manual out anywhere?

A. I don't think I would express it that way. In some cases where towns had developed to a point where dial operation would be substantially more economical than the [fol. 148] present manual, in that case the manual might be displaced by dial.

Q. I don't understand economical, because wherever you put in dial equipment, you want higher rates, don't you?

A. That isn't always true. There are some types of exchanges where dial installation would necessitate a higher rate, but in the types of exchanges where dial is generally put in, that is not true. In the bigger exchanges the dial is more economical.

Q. And you estimate now that you can actually put in new dial equipment and operate at less expense?

A. In some locations. Not all locations.

Q. Can you say whether or not any switchboards were included in the calculation you have shown on page 5, where the switchboards had served their full life?

A. Well, in developing that service life, we had the average service life of all the plant we had installed everywhere, but this figure is related to the average over-all life of only those boards which are now in service.

Q. And of course none of which have been retired?

A. None of which have been retired. The average service life of retired boards would probably be substantially less than that.

Q. Then as a matter of fact, this statement showing depreciation of boards is based on your judgment?

A. To a large extent, our judgment backed up by considerable amount of experience as to the relation between average service life and total life, based on definite experience.

Q. But you don't want us to understand that you have made a tabulation here based on the number of boards that have been retired?

[fol. 149] A. No, sir, not at all. That is in the background, but it does not determine the answer itself.

Q. You did have some experience in your mind, or in the minds of the company that helped you form a judgment?

A. Yes, sir.

Q. When you looked at the boards?

A. Yes, sir.

Q. Now, isn't it the practice of the company to keep these boards in good operating condition?

A. Yes, sir.

Q. You have replaced the wearing parts as rapidly as they require?

A. Yes, sir.

Q. And at any time you would inspect a board you would expect to find it in first class operating condition?

A. Yes, sir, practically equal to a new one.

Q. And these minor replacements, depending on the size of the replacement, would be charged to maintenance?

A. Most of the minor replacements would be maintenance. If it were all taken out it would be through depreciation.

Q. So even tho a board might be five years or ten years old, it would be in first class operating condition?

A. Yes, sir.

Q. Let's suppose for some reason you take a board out that has remaining wearing value in it. What would you do with it?

A. If it were a type of board we could reuse some place else, we would either place it in storage in anticipation of the reuse, or we would take it to the site where it was to be reused and proceed to install it. If it were a type of board [fol. 150] that had no field for reuse, we would sell it for junk and get what we could out of it.

Q. You can add new equipment on the boards in your repair rooms, can you?

A. You mean do such things as modify cord circuits, etc.?

Q. Yes.

A. Not as a general practice. They can repair parts, but it isn't very often they substitute a new type of parts in existing frame work.

Q. Did you, in your study, find out the percentage of the boards that were removed that did not go back into plant?

A. We have that information, both as to the number of boards, and as to money, but I don't have those figures in my head.

Q. Did you use those figures in this study?

A. Not directly, because many of those boards that have been retired, were retired under conditions so different from those that will exist when the present plant is retired, that those figures would not help us any. At one time a manual board taken out had a very good chance to be reused, but now the reverse is the case, because so many manual installations have been replaced by dial that there is a surplus of manual boards for reuse, with the result that there is no salvage on those taken out now.

Q. Isn't there any sale for those boards to the smaller companies?

A. Very little sale—very limited. The largest amount of investment represented by our retired boards is in boards of a type most of the smaller companies could not use. Number 1 boards, for example, would be too large for most of the smaller independent exchanges.

[fol. 151] Q. I believe I asked you, but I would like it answered again. Did you figure in all cases that the manual boards would be retired and replaced with automatic equipment?

A. No, sir.

Q. Having in mind the average town in Nebraska with a manual board or common battery board installed, with a reasonable capacity as you would install it in good operating condition, can you tell us why you would take that out other than for reasons of wear and tear?

A. It might be taken out for reasons relating to service. The board might not be suitable to meet conditions that might develop in the community. For instance, a magneto board might not suit a progressive community. After it had been in a certain length of time, it might be a type of community, or develop into a type of community that could be served, with appreciably less cost, by an automatic board. Occasionally a board is retired because of fire. Occasionally it is necessary to move to other quarters because the neighboring buildings might become of a character that make it undesirable to stay there. For instance if a kind of a plant that is a severe fire hazard starting up right next to a building housing a telephone exchange, we might move that exchange because of increased hazard.

Q. Your company has engineers, of course, and then you install equipment they make engineering studies of the situation?

A. Yes, sir.

Q. And install equipment that is needed for that particular exchange?

A. Yes, sir.

Q. Is it customary for your company to put any switch-
[fol. 152] board in where there is a bad fire hazard?

A. No, sir, but occasionally a board is placed in rented quarters which, at the time the installation is made, are satisfactory from all respects, but we have no control over what is done with them later on, and quite a few of our medium sized offices, and practically all the smaller ones, are in rented quarters.

Q. Is it your experience, or within your knowledge, that the public demands improved service sometimes?

A. Yes, sir.

Q. Has that happened enough to be a factor in depreciation?

A. Yes, sir, it has happened enough to be quite a factor.

Q. You want us to understand that some of these changes are because of public requirement?

A. Yes, sir, particularly change from magneto to common battery, very often is started by local chambers of commerce.

Q. You don't have reference to common battery boards when you talk about public demand?

A. Well, public demand with respect to common battery boards might not be quite so direct. The demand might be for better service, without knowing how that better service could be accomplished, and in a magneto service, of course, they all know there is a crank to turn that they don't have to turn if the switchboard is the common battery type, so they bring their pressure directly to the point demanding common battery service. Improvement of service of any kind might require a change in equipment, although those that demand it might not express it as a desire for new equipment.

Q. Can you, from your own information, name how many magneto boards your company has in Nebraska?

[fol. 153] A. I would guess about seventy-five or eighty, but that is more or less an estimate. My impression is about a hundred and fifty in Nebraska and South Dakota together.

Q. It is not the plan of your company to operate magneto boards, is it, any longer than you have to?

A. Well, not any longer than we have to. If you mean have to, we may have to change them.

Q. Then as far as a change from magneto to common battery boards is concerned, it really isn't a very large factor in your depreciation now?

A. No, perhaps not, but the principal reason for the retirement of magneto boards would be to give common battery service.

(At this point a ten minute recess was taken, after which the taking of testimony was resumed as follows:)

By Mr. Forbes:

Q. At this point, Mr. Granfield, I will ask you to distinguish, for the purposes of the record, between maintenance expense and depreciation?

A. Well, the charges that are classed as maintenance, and those that are classed as depreciation, are rather definitely defined in the Standard System of Accounts, and we follow that division. The way it is accomplished, is to have various classes of property sub-divided into items, and anything smaller than one of those items would be handled as an expense, while those items or units of property above are handled as through the depreciation. Of course any addition to the capital account, even tho it is [fol. 154] less than a unit of property, is capitalized, but the replacement of items smaller than a unit are handled under expense.

Q. Ordinarily repairs, then, on the switchboard, would be charged to maintenance?

A. Yes, sir, new plugs and cords and things of that kind.

Q. And you would charge practically all of the expense of keeping the board in operation to maintenance?

A. Yes, sir, except for example when you have to replace batteries or battery plates, that is ordinarily handled through depreciation. If battery wears out, storage battery, and is replaced, that is a large enough item so it is handled through depreciation.

Q. You distinguish between maintenance and depreciation charges on rules provided by the Interstate Commerce Commission Rules of Accounts?

A. Yes, sir.

Q. Well, now, when you take out a board and repair it and it is put in service again, you charge a large part of that to maintenance?

A. Yes, sir, reservicing the board is a maintenance expense almost entirely.

Q. Is that repair work that is done on the board, including minor replacements, then charged to the operating expense of the exchange from which it came?

A. Yes, sir, charged against the exchange where the wear was incurred.

Q. On what theory do you do that?

A. That is prescribed accounting, the theory being that the exchange from which the board was retired incurred the wear, and the cost of repairs necessary as a result of [fol. 155] that wear are charged back to that office.

Q. But this puts the board, for the purposes of this company, in first class operating condition?

A. Yes, sir.

Q. Makes it, for service purposes, as good as new?

A. Yes, sir, but the board is taken in at the new location at the cost of that board new.

Q. Then the board goes out into its new location at its original cost new?

A. Yes, sir.

Q. And all repairs necessary to put it in that condition are a proper charge to the exchange from which it came?

A. Yes, sir.

Q. That is, you say, on the theory that that was an expense that hadn't been previously charged?

A. Yes, sir, but was incurred at the original location.

Q. However, if the board should wear out in its location, there would be no back charge to the exchange on account of maintenance?

A. No, sir. In the case where there is a charge back to the exchange, there is also a salvage credit equal to the amount capitalized at the other exchange.

Q. Well, where there is a salvage credit, do you credit that particular exchange with the salvage?

A. Not directly, no.

Q. You charge them with the expense, but you don't credit them with the salvage?

A. That is substantially true, yes. Salvage accounts are handled on a company basis, not on an exchange basis.

Q. Don't it occur that if maintenance expenses have [fol. 156] been realized that you credit maintenance from time to time and perhaps annually, with certain expenses and charges to reserve?

A. I am not sure I get that question.

Q. Does it happen that annually, or monthly, or any other period during the year, you may credit maintenance expenses and charge them to the depreciation reserve?

A. I am not sure about the present mechanics of that accounting.

Q. I will ask Mr. Baird to answer that question.

By Mr. Baird:

A. I presume, Mr. Forbes, you are referring to the report for the year 1932 which you have on file?

Q. You can use that report.

A. Page 303 of the report in question shows under telephone operating expenses the maintenance expenses of the company. It shows as one item, Account 611, Repairs charged to reserve—credit. That represents the amount that goes finally to the reserve account for items that come under the general category of extraordinary repairs, for the purposes of the report. The Interstate Commerce Commission required us to include such amounts originally in the current maintenance account, and then show them in the sub-account 611 at the foot of the report. We do not report those items in that manner. Other reports of ours will show such items of extraordinary repairs as directly chargeable against the reserve.

Q. What's the reason for that?

A. I really don't know what they had in mind in setting them up that way. The net effect is exactly the same. It merely raises the amount of current maintenance, and then [fol. 157] takes those amounts out of current maintenance again at the bottom of the report.

Q. How do you know what to put in this amount?

A. We did that under this system. We carried sub-accounts of our current maintenance accounts for what we term "Y" charges. That is extraordinary repairs, and those charges were all passed into the "Y" account as the sub-account of current maintenance, but the effect in all our reports was to clear them out each month and transfer them to the reserve.

Q. What are extraordinary repairs?

A. Under the old system of accounts, extraordinary repairs represented the cost of storm damage. For instance, we have a sleet storm which wrecks our lines, we will show as extraordinary repairs, the items that ordinarily would be treated as ordinary repairs, such as repairing breaks, stretching wire or strengthening poles. That account will also show the cost of replacing plant wrecked by storms over and above what we would term a current cost. Those items are all included in extraordinary repairs, and under the old system of accounts were charged against the reserve for depreciation.

Q. Then do I understand you to say that in the event you have storm damage at one or more of your exchanges, the full cost of that storm damage is charged against depreciation reserve?

A. Under the present system of accounts, the charges to depreciation are confined to retirements of units of property. All other elements of expense are charged to the current maintenance accounts. The two systems of accounts differ in that respect.

Q. What has been the practice under the old system?

A. Under the old system all expense of a certain nature, [fol. 158] which would include retieing wire, strengthening poles, temporary wire, and work of that kind, has been charged to the depreciation reserve under a general caption, extraordinary repairs. The replacement of units of property have been handled through the depreciation reserve, as they are today, except that the excessive costs of replacing wire under storm conditions, under the old system was segregated as extraordinary repairs. I don't know whether I make that clear or not, but there was a difference between replacement of units of property and extraordinary repairs, and in the extraordinary repairs category, was included the excessive cost of replacement of poles, for instance, but it all went into the depreciation reserve, part of it being taken through these extrraodinary repair accounts.

Q. I wonder if this is true, Mr. Baird, by reason of the extraordinary repairs, insofar as it includes strengthening of poles, cross-arms and perhaps splicing wire and replacement of insulators, things that would ordinarily be charged

to maintenance, since they occur in a storm you charge them to depreciation?

A. That was true under the system of accounts that was in effect prior to January 1, 1933. Under the present system of accounts they are charged to ordinary repairs. Items of that class you mentioned are classed——

Q. They would appear in the maintenance?

A. Yes, sir. That's right.

Q. Would it follow, then, for that reason, there would be considerably less demand on your reserve in the future than there has been in the past?

[fol. 159] A. Somewhat less. It is not a very large factor. Mr. Granfield, I think, can quote the percentage amounts that are affected by the item.

Q. This item you have been discussing is for some $350,000. Wouldn't you consider that a substantial item?

A. It all depends on your viewpoint. In contrast with the total maintenance expenses, or total depreciation, it is not a very large item, and I think that year was rather excessive. It ordinarily doesn't run that much.

Q. Whether it is large or small, according to future accounting, you don't expect there to be any credit to your maintenance for extraordinary repairs?

A. No credits, no, sir. All of the extraordinary repair items will go directly to maintenance. There will be no transfer to depreciation reserve.

Q. Whatever the amount is you have been crediting maintenance with in the years past, you will do that in the future under the new accounting?

A. That's right. It wasn't a credit to maintenance.

Q. Taken out of maintenance?

A. Well, it was so treated in the report to the Commission, so far as our reports were concerned. In our accounting we passed each month directly to the depreciation reserve.

Q. But however you consider it, whether it's your account or reports or whatever you use, your reserve will be relieved of that burden in the future?

A. That's right, with one possible exception, that the construction account reflecting poles installed as a result [fol. 160] of a storm, the accounts will reflect the original

cost, even tho they may be installed under storm conditions, and the cost somewhat in excess of normal costs.

Q. Mr. Granfield, you say you don't repair the switchboards removed from service any more, except in unusual cases?

By Mr. Granfield:

A. Very rarely that we have an opportunity to use the board, and when we don't reuse it, we junk it without spending any money on them.

Q. What do you do with them?

A. Usually get bids from the Western Electric Company on the value of materials as junk, and they pay us a certain amount and take it off our hands, take it as junk, and the metals, etc., are reclaimed.

Q. Do you have an agreement with the Western Electric Company to take these old boards?

A. I am not sure that they are obliged to take them. We ask them to bid on them, and they do take them, but I don't think they are compelled to take them off our hands, because it's too uncertain a proposition. A small board we probably would take out ourselves and junk.

By Mr. Forbes: I think that is all on this division, Mr. Bollen.

By Commissioner Bollen:

Q. I think you stated, Mr. Granfield, that in changing an exchange from manual to dial, that you sometimes did it in the interest of economy. Does that mean that after you [fol. 161] had made the change that you could operate the exchange for less money?

A. Yes, sir, we could handle the same amount of service with the dial installation at a lower over-all cost than we could with manual, if the change was made for that reason.

Q. And that is of course due to the fact there is less operating expenses, largely, isn't it?

A. In exchanges of certain types. There might be an exchange of a type where the installation of dial would be made because people preferred it, where it might be less economical.

Q. In determining your depreciation rate, do you take that factor into consideration?

A. The only way that would enter in determining the rate would be through bringing about the retirement of manual offices, and——

Q. Oh, I mean is the fact that you are now able to operate this exchange more economically—do you take that into consideration in fixing the depreciation rate for that kind of property?

A. I am not sure I understand just what your question is aimed at. The replacement of manual requipment with dial would effect only the manual depreciation rate, if it affected any.

Q. The fact that can be replaced by the dial, and you can work an economy in your operating expenses, do you take that fact in consideration in fixing your depreciation rate on your manual equipment?

A. Not directly. The only way that would effect the manual rate would be through the bringing about of the retirement of manual offices by replacement with dial. As a matter of fact it is not a large item in the depreciation rate.

Q. Would it be a factor?

[fol. 162] A. Yes, if we could operate all our manual offices cheaper by dial it would mean——

Q. As a matter of fact, isn't it true when you change the ordinary exchange from a manual to a dial, you increase the rate at that exchange?

By Mr. Peycke:

Q. The depreciation rate or charge?

By Commissioner Bollen:

Q. No, the rate for service?

By Mr. Granfield:

A. You say the ordinary exchange. I say the exchanges where dial is used to the greatest extent, the rates have not been increased because of the dial. Small exchanges, where a dial was wanted for some reason other than cost of service, that might be the case, but at the larger exchanges the economies are sufficient so that no rate increase is necessary.

Q. Do you mean to say that where you have a group of ten exchanges that come in the same class, and nine of

those are manual and one is dial, you make no distinction in the rate of that exchange on that account?

A. Might and might not. But as I recall, there are few, if any, of our dial exchanges which have been made dial with an increased rate. At some of the small ones, of which we have very few, that may have been the case. Because in some situations where there are less than four or five thousand stations and more than three or four thousand, a dial might be more expensive than manual.

[fol. 163] Q. Where such cases do arise, do you take that into consideration as a factor in fixing your depreciation rate?

A. The rates paid for service don't enter at all in our calculation for depreciation.

Q. You don't consider that at all?

A. No, we just consider that in the abstract. We merely want to find out what the service life and salvage would be in the current operating plant.

Q. The record shows the larger part of your depreciation reserve is invested in plant upon which you claim a fair return. Do you take that return in consideration as a factor in fixing depreciation?

A. No, sir, we pay no attention to return.

By Mr. Peycke:

Q. Did you take into account, to whatever extent it had any importance, this change in account with reference to extraordinary repairs, in calculating depreciation rates?

A. Yes, sir. This schedule is based entirely on the System of Accounts now in effect, which is in accordance with the order of the Interstate Commerce Commission.

By Mr. Forbes:

Q. Please be referred, Mr. Granfield, to station apparatus, Page 6, Exhibit 1, and I will ask you to tell us in your own way how you arrived at the service life of five and a half years, the net salvage of 65%, and an annual depreciation of 6.4%.

A. The status apparatus account has a higher rate of [fol. 164] turnover than practically any account we have. The station's average life in one location is the basis of the depreciation rate, in accordance with an accounting treatment that this apparatus gets, and we determine it by what

we call the turnover cycle method. That is, we find out how many stations are retired in a given year, or series of years, working back from the present, and total those retirements until they are equal to the investment at some time in the past. For instance, if we started in 1930, at the end of 1930 and took the total retirements for 1930, added them to the retirements for 1929, and the retirements for 1928, say we got back then to say 1925, and found out that the retirements accumulated in those four years were equal to the total amount in service in 1925, that would be what we call a turn-over period of four years—five years, from 1930 back to 1925. We made several series of those to find out what the trend was, and we went back some ten or twelve years in our experience and found out that counting back from 1930, say four years, we get a complete turn-over. Going back from 1929 it might have taken four and a half; from 1928 back might have taken five. We had all those results measuring the rate of turn-over of this equipment.

Q. The rate of turnover for the last few cycles has indicated a shorter service life than this five and a half, due to the large number of cancellations of service, terminated service life of stations, so that this five and a half is somewhat longer than we have experienced in the immediate past.

Then the salvage is based on a study of the over-all lives of all stations. Each station taken out has some prospect for re-use so to determine what that was, we made a turn- [fol. 165] over cycle study on what is sometimes called a cradle to grave basis, to get the over-all life of the apparatus from the time it is first put in service until it's finally junked, and that was found to be somewhere in the neighborhood of fifteen years. I have forgotten the exact figure. By relating that over-all service life to the location life, which was around five years, we found that the average station apparatus goes through three location lives, a little over three. At the end of the first location life it has 92% salvage. At the end of the second location life, the salvage is about the same. At the end of the third location life it is ready for junk and the salvage is a small amount, four or five percent, so that the salvage we may expect from station apparatus is an average of the salvage at the time of each retirement, and that averages twice ninety-two plus, four or five, divided by three or three and a fraction, giv-

ing an answer of 65% salvage. It is necessary to go through that computation instead of taking an average directly from the books, because the books at any time may reflect an abnormal or subnormal percentage of final retirement, and with the final retirement with practically no salvage, the book average is not correct for the salvage of all the plant we have on the books. These figures are based on the very exact calculations.

Q. Let's take a phone in one location and see if we can understand what you mean. Assume that there is a telephone in this room. It's the first time the telephone has been in service. It remains in this room in service for a period of years, then it's removed from service—discontinued. It's taken to the warehouse I take it. Are there [fol. 166] any repairs made on the phone?

A. Yes. It is run through the shop and any repairs that are necessary are made, and if it is not worth repairing it is torn down, and any parts worth saving are saved.

Q. Let's say it is a comparatively new phone, or phone in good operating condition. The phone is examined and found to be in good service condition, and later on it's installed in a different location. In that transaction, is there any charge to maintenance or depreciation reserve?

A. There is a charge to depreciation reserve of the cost of that instrument, and there is a credit to the reserve of the salvage on that instrument, and if the instrument is re-used without any repair cost whatever, there will be a charge to depreciation of the supply expense which would be lost when the instrument was taken out and later replaced. In other words the supply expense does not accumulate. We get salvage for an instrument less supply expense.

Q. Do I understand there is 35% charged to reserve?

A. No, a very small percentage, three, four or five percent. I don't know what it would be, depending on what the supply charges were running at the time. There is an expense in connection with warehousing supplies, and that amount varies from three to five or six percent. If an instrument is worth $10.00, there is a warehouse charge of three or four percent, and when that instrument is installed that supply expense is capitalized. When the instrument is taken out, regardless of whether the instrument is serviced or not, that supply expense is lost, and the instrument

goes back to the warehouse to be installed again, the supply [fol. 167] expense would be incurred a second time—the warehouse charge.

Q. You don't make any charge to the reserve of the expense of the warehouse expense, until the end of the life of the instrument?

A. No, except for, I think perhaps, some replacements. For instance, the handle of the transmitter, or something of that kind, might go through the reserve. I have forgotten just where they draw the line on that, but if they replace a substantial part of the set, it would go through depreciation.

Q. Well, suppose they just check the electrical contacts and find the phone in good operating condition, what charge would be made?

A. Be no charge except the warehouse charge.

Q. What's that?

A. Supply expense—three, four or five percent.

Q. For the cost in passing it through the warehouse?

A. Yes, for handling it.

Q. And that would be a charge to the depreciation reserve?

A. Yes.

Q. On what theory do you charge warehouse expense to the reserve?

A. It is what we call supply expense. We buy these instruments at a certain cost, plus supply expense. If the instrument is $10.00, the supply expense might be 40¢ or 50¢, so the cost to us would be $10.50, but the instrument itself is worth only $10.00, so when we salvage this instrument the salvage is only $10.00 and not $10.50.

Q. That supply expense is the cost of handling, isn't it?

A. Yes, partly.

[fol. 168] Q. Don't have anything to do——

A. It is a capital charge.

Q. It is the amount you add to the manufacturer's cost?

A. I perhaps left out a step—that's Western Electric supply expense. The Western Electric incurs that supply expense.

Q. Let's see, when you buy the instrument there is a supply expense of 50¢ for the instrument. That's for handling it?

A. Yes.

Q. Storage and handling in the warehouse?

A. Yes.

Q. On what theory do you charge that expense to the depreciation reserve?

A. That is capitalized when the instrument goes in plant, and when the instrument is taken out of the plant, its value was not increased by the supply expense, so the salvage cannot equal the initial cost by that amount.

Q. Supply expense is part of the cost of the instrument on the theory that it is going to be passed through the warehouse a certain number of times?

A. No, I don't think that is it. Supply expense is the cost of handling all the supplies we have handled for us by the Western Electric, who handle our supplies, and some expense of our own in handling the supplies, and that is capitalized as part of the cost of the instrument.

Q. Why isn't that an operating expense?

A. Well, I don't know what the reasons for classifying it as it is are. It seems to me the cost of apparatus would logically include the cost of warehousing it before you get it. [fol. 169] Q. All these instruments you take out, you pass through these storehouses before they come back into plant?

A. Not all of them. A few of them are handled locally. For instance, in some small exchanges out in the state, they may take out a new instrument, and that isn't sent back into the shop if there is nothing wrong with it. If there is nothing wrong with it, or if it requires only a small adjustment, they don't send it back.

Q. How is that handled in the ordinary sized exchange in Nebraska? Are they sent to Omaha?

A. Not the ones that are obviously in good condition, but those that require extensive repairs would be sent then to the shop which handles them on a wholesale basis at Omaha. Those that are in good condition might be checked locally, and used again.

Q. Then there wouldn't be any charge in the small town if an instrument was taken out of plant and not repaired and returned to another location?

A. Yes, sir. This charge is an average for all instruments; some are more and some are less, but an average is applied to all of them.

Q. Where do these changes occur, you speak of, that require so many instruments to be taken out?

A. There is an instrument to be taken out whenever a subscriber discontinues service, unless it is expected to be reconnected fairly promptly, and in that case it is left in.

Q. Then there is a charge made out in the small exchange, whether there is anything actually——

A. We have to displace instruments from the premises, and also from the books, and put it in the supply account until we use it again. There is a certain expense in con- [fol. 170] nection with handling the supply account, and that is averaged over all supplies handled.

Q. In other words, each time the instrument is installed or taken out, you amortize the 50¢ on the original capital account?

A. Whatever the amount may be.

Q. So, regardless of whether there have been any repairs made, or any changes, in the instrument out at one of your small exchange-, there is no reason to send the instrument to Omaha for general repairs, however, there is a charge to reserve because of the amortization of that 50¢?

A. Supply expense, whatever it might be.

Q. And that 50¢, or thereabouts, is supposed to be taken out of plant in that way?

A. Yes, sir, that is my understanding.

Q. And finally, when the instrument goes out for the last time, you take $10.00 off, and not $10.50?

A. No, you take out $10.50, because there is a supply expense every time it goes in. The instrument is handled in supply account whenever it is put in plant, then the handling charge is averaged over all the materials that come out of the supply account.

Q. This man at the local exchange, he charges that into the supply account when it comes in, and then credits it out, and in that process he amortizes the 50¢?

A. Yes, sir.

Q. And that is charged to the reserve?

A. Yes.

Q. Where do you figure your company gets any value from the 50¢?

A. It is necessary expense in connecting with handling [fol. 171] supplies. We can't warehouse materials and

handle them and house them for use without incurring expense.

Q. Out at your ordinary exchange, however, you have a local manager perhaps, and a plant man. The plant man brings the phone in and he puts it in the store room and the next day he's ordered to make an installation and he takes that phone out and put it in plant. The mere fact it has passed through the store room is the reason why you make a supply charge?

A. Yes, sir.

Q. It has no reference whatever whether the phone is handled by the Western Electric?

A. The average cost of each is applied to all. Some would have a high cost and some low, but the average is applied to all of them.

Q. You get that privilege there in Omaha of passing your phones through the warehouse. Do you know what percentage they actually handle of those phones?

A. Of all instruments taken out?

Q. The Western Electric?

A. No, I can't say offhand, but it is a large percentage.

Q. But if a phone comes in, even if they don't go to the Western Electric, a fraction of that 50¢ is charged——.

A. The supply expense is allocated.

Q. Notwithstanding the fact that the same employees are included in other company expenses?

A. There would be no duplication of expense there, because the only expense charged is the actual supply expense for that period averaged over supplies handled, no matter [fol. 172] where the expense was incurred. That expense is not charged in two places. The only expense in this figure is expense actually incurred and charged to supply expense.

Q. Is any credit given to the expense of the exchange for this 50¢ where the plant itself handles the telephone?

A. If there is one telephone that has no supply expense, the effect would be to lower the supply expense on all the others. Of course that case you are citing is not a usual case. There are certain types of transmitters and receivers which, after they have been in service a certain length of time, are not reinstalled without careful check and perhaps not reinstalled at all, because they are known to de-

teriorate with age, and those would be sent into the Western Electric Company regardless of their apparent condition, whenever they are taken out.

Q. Talking about the ordinary practice when a phone comes out of plant and goes back without any major replacement—I am trying to find out whether there is a charge every time it comes in the storeroom?

A. There is an average charge every time it comes in the storeroom.

Q. Until the 50¢ is amortized?

A. Whatever the amount may be. The way it works is this. The station in place represents the cost of the apparatus plus the supply expense. When a station is taken out, obviously all we can salvage is the instrument. We can't salvage the supply expense, so that is lost, so no matter what becomes of that instrument afterwards, that supply expense is permanently lost and is charged against reserve. If that instrument goes in again, there is supply [fol. 173] expense capitalized on it again, because the instruments are not kept separate, and some of them charged with actual expense and some others on an average basis. So all the instruments going in on a given date, for instance, take the same supply expense, and all the instruments that come out we salvage merely the material, because that is all there is that has any value when they are taken out.

Q. Did you say what this percentage is that is charged each time the instrument is taken out?

A. How much it is?

Q. Yes.

A. It fluctuates from time to time. Oh, I would say it averages from three to six percent. We have records of that. I don't know what the present rate is.

Q. That is 6% of the 50¢?

A. No, of the cost of the apparatus, 5.74 average supply expense of all materials handled, and it is allocated as a flat amount on all equipment.

Q. Each time it comes out of plant and each time it goes back into plant, there is 5.74 supply expense included in the cost of the unit?

A. That is the amount that is displaced, and is not salvage.

Q. Do you have any instruments that are ruined or broken up or lost?

A. Quite a substantial number of broken parts. A rare case where the whole instrument is ruined, but the standard may be ruined or the bell box may be destroyed. There is a lot of breakage of receivers and with these handsets, the [fol. 174] whole instrument sometimes gets broken.

Q. Then, if you should change from magneto to common battery, or common battery to dial, and those instruments should come into Omaha for repair, they would be repaired and put in shape for service again, and that maintenance would be a charge to the exchange from which they came?

A. I don't know whether the maintenance or the repair expense for station apparatus is charged back against the exchange or not.

Q. Can you tell us, Mr. Baird?

By Mr. Baird:

A. I think the method we are using now is to apportion that expense on the basis of the number of sets removed during the month. You can't tag the individual set, you understand, so we have to devise some method of spreading that expense.

Q. Is it the intention to charge some amount back to the exchange?

A. That's right. It is the intention.

Q. On whatever basis you compute it?

A. That's right.

Q. You regard it as a deferred maintenance item that is chargeable to the exchange?

A. That's right.

Q. Then the instrument may go back into plant practically a new instrument for all purposes, and charged back new?

A. Yes, sir.

Q. And begin over again?

A. Yes, sir.

[fol. 175] Q. When the instrument goes back into service, does it have the 50¢ added to the cost the same as it did before?

By Mr. Granfield:

A. As supply expense, whatever the amount may be.

Q. And you work that cycle as often or as long as the instrument lives?

A. Yes, sir.

Q. Finally, what do you charge to reserve, when the instrument goes out the last time?

A. The cost of the instrument as determined, the average retirement cost.

Q. 50¢ in that too?

A. Whatever was on the books at the time it was retired, is charged against the reserve. Any spare pieces that are salvaged are credited to the reserve.

Q. What are the factors of depreciation in a telephone?

A. Instrument?

Q. Any telephone?

A. The principal factors are the rate at which the subscribers discontinue service, because the length of service in one location is a large factor in the rate. If there is a change in type of service, that brings about retirement. If there is a decline in business and people disconnect their telephones, that brings about retirements. Retirements from breakage, retirements from change in type of service, some retirements from the development of better instruments or from higher transmission requirements from many stations. For instance, a subscriber might be located so that it would require an especially high class type of trans- [fol. 176] mitter to give him the same class of transmission that others are getting. And there is some retirement from the aging of the transmitters. They may get insensitive from various causes.

Q. In arriving at your percentage, did you consider that telephones might become obsolescent?

A. No, sir, we considered nothing except what was reflected by our definite experience, and the rate of turn-over, and the return in the way of salvage. We considered nothing besides those, except the trends indicated during the last few years with respect to changes.

Q. Is the rate that you have used based on a mechanical calculation or is it a matter of judgment to some extent?

A. The salvage is based on a definite calculation, and the service life is based on a series of calculations which indi-

cate what results had been for several periods in the past, and we have selected the rate of turn-over which, in our judgment, applies best to the present time and the immediate future. To put it more definitely, the last experience we have had analyzed, bringing it up to date, indicates a somewhat shorter service life than five and a half years. That service life has been shortened quite a little by the heavy loss in stations, so that in setting up our rate, we didn't take that extremely low service life, but as a matter of judgment, increased it to what we might except it to be in the future.

Q. You made that rate looking backward or forward?

A. Looking forward. We were trying to get rates that apply to the plant that is now on our books, and therefore we are concerned with what is going to happen to it from now on.

[fol. 177] Q. How many telephones did you consider in this calculation?

A. A good many thousand. I don't have the exact number, but I would say hundreds of thousands.

Q. For all your territory?

A. Yes, sir.

Q. How far back did you go?

A. I think the studies that we relied on went back to about the time of the war. I don't think we paid much attention to studies going back of that period.

Q. Did you attempt to allocate by trades or territories and location the allocation of this depreciation?

A. No, sir, we made our studies on the combined data for the entire company, for all classes of plant except poles.

Q. Isn't it a fact, Mr. Granfield, that these changes you speak of would occur in the larger towns?

A. Some of them. In small towns you get changes from magneto to common battery, which necessitates a larger retirement of station apparatus than a change from manual to dial.

Q. But in a large business district, you are taking phones out and putting them back all the time, aren't you?

A. Yes, sir.

Q. You are doing that in Omaha all the time?

A. Yes.

Q. Do you have that same experience out in the small towns?

A. Perhaps to a somewhat lesser extent. I don't recall ever having seen figures on it. Of course in the last three years we probably have had a higher percentage of disconnects in the smaller towns than in the larger.

[fol. 178] Q. Did you make a study at any time on the basis you have outlined here, and include only the small towns?

A. No, we have not.

Q. You didn't attempt to locate where this expense occurred?

A. No, sir, we were making rates to apply to the entire property and made no sub-division except that one I cited, on poles.

Q. Might have been Des Moines or Minneapolis or some other place?

A. The entire experience of the company.

By Commissioner Bollen:

Q. Where a phone is ordered taken out, and you go and take it out, you described the process you went through. You have a charge, don't you, for reinstalling that same phone even in the same house?

A. Yes, sir, the installation charge applies.

Q. What do you do with that installation charge? What becomes of it?

A. That is an accounting question. I think it goes into revenue. I am not sure. That didn't enter into the studies at all.

Q. Wouldn't it be proper to use part of that to take care of the storage charge?

A. The station apparatus account, as carried on the books, does not include any labor charges for installing it at all. The only amount that is capitalized is the cost of the apparatus and the cost of the apparatus consists of the purchase price plus the handling charge. The cost of installing it, and all the installer's time is charged to expense or to the station installation account. Anyway it isn't capitalized as station apparatus at all, and I presume the installation charge collected from the subscriber is merely an off-set to the installation cost which is not capitalized [fol. 179] in the first place.

Q. In changing to the monophone, what are the steps taken by the company in your accounting system?

A. You mean if a man has a desk-set and wants to have it replaced by a hand-set?

Q. Yes, sir.

A. The station that is in service is taken out and displaced from the books, charged to depreciation reserve. Whatever the value of the set is is credited as salvage when it is reused, and the cost of the hand-set is capitalized. In other words, take one set out and take it out of the books, and put one in and put it in the books. On the one that is taken out we may realize some salvage and that salvage is credited to depreciation reserve.

Q. Then the actual charge you make for the hand-set wouldn't enter into the transaction?

A. You mean—no. The rental or rate paid for the set doesn't enter or affect these studies at all. Revenue is a different problem. Rental rates are a matter of revenue.

Q. That goes into the revenue account?

A. Yes, sir.

At this point it being 5 o'clock p. m., the taking of testimony was adjourned until 9 o'clock a. m., Tuesday, March 20th, 1934, in the Commission's Hearing room in the Capitol Building, Lincoln, Nebraska.

[fol. 180] It being 9 o'clock a. m., Tuesday, March 20th, 1934, the taking of testimony in this matter was resumed as follows:

By Mr. Forbes:

Q. Mr. Granfield, will you explain your method of finding the depreciation rate and salvage as shown by your Sheet 5, for private branch exchanges?

A. Private branch exchange account is separated into two parts, to determine the depreciation rate. The first part is called Other Systems in the I. C. C. schedule, and that is what we call non-multiple private branch exchanges. They are rather small installations and so-called cordless boards. They have a life, consequently, somewhat similar to an ordinary telephone instrument, except that they have a longer average life, and not as many life cycles. We made studies of the average life in one location for these boards, in the same way we did for station ap-

paratus. We used the same turn-over cycle method, and we also have studied that class of plant by mortality studies, and we rely on the mortality studies for the indicated life more than on the other methods.

The mortality study method, I think might be a little bit easier to explain if I defer it until we talk about poles, because poles are a little simpler item than P. B. X., but whichever you prefer. If you want me to go into an outline of the mortality study method in connection with P. B. X.'s I will go through it now, or I can take it up in connection with poles, which are a little simpler illustration than the P. B. X.

Q. What is the attitude of the Commission?

[fol. 181] By Commissioner Bollen:

A. However you want it in the record.

Q. We might wait until we come to poles, with the understanding that this method will be outlined in that connection, and referred to.

By Mr. Granfield:

A. I think it is a little simpler to explain poles, as an example. The service life indicated by the mortality studies for P. B. X. for non-multiple boards varied slightly for the different periods analyzed, and it was our judgment that nine years would be the appropriate service life to use in the future. As a matter of fact, the service life we have been realizing in recent years is close to that figure, and during periods of relatively low business activity, the service life of private branch exchanges tends to be low. That is, there is a high rate of disconnection of private branch exchanges, just as there is for station apparatus. The salvage on non-multiple boards was determined in substantially the same way as the salvage for station apparatus. That is, we determined the over-all life of a board, and also the number of location lives for the board, and determined the salvage, average salvage at the end of each location life, and averaged the salvage, including the salvage at the termination of its useful life, and got an answer of 45%.

The private branch exchange accounts include some cost [fol. 182] of installation, which is lost when the board was re-used. The other part of the private branch exchange

account, which is called Special Systems in the schedule, is what we refer to as multiple private branch exchanges. That includes the larger installations and the automatic private branch exchanges and the large order tables—installations of that kind. These installations are generally similar in characteristics to small exchange switchboards, and we have studied them in the same way that we studied the small manual switchboards, and the service life resulting from that study was 9½ years as a service life, based on those studies, and the salvage 20%.

The manual multiple private branch exchanges have not as much value for salvage as was formerly the case, because dial installations are being used more extensively. Many users of private branch exchanges prefer to have dial installations which do not require any full time operator to handle the calls, so most of the new installations tend to be dial.

Q. As I understand you, you didn't base your conclusions on any inspection of the equipment?

A. No, sir. It was based, for the non-multiple boards, on a mortality analysis of our past experience in what we call bands. We took the mortality for a period of three years, and determined what service life that rate of mortality would produce. Then we took another band of three years, the succeeding band, and made a determination. From those determinations we get not only the average service life indicated by the mortality in each band, but we get an indication of whether the service life is trending upward or downward.

[fol. 183] Q. In your study, did you include the cost of installation?

A. Yes, sir, the cost of installation is capitalized in the account, and therefore was included in the study.

Q. Did you take into consideration, and if so how, what charges are made for the installation of private branch exchanges? In other words, what amounts are paid to the company?

A. Oh, I misunderstood your question. I thought you meant the cost to the company of installing the boards. Did you mean contributions from the users?

Q. Yes.

A. No, that was not given any consideration, as it would have no effect on the service life and the salvage which we determined was related to whatever was on the books.

Q. Then, as I understand you, you did consider the private branch exchange as installed?

A. Yes, sir, in place.

Q. But you didn't consider any amount that might be paid to the company as a part of the installation charge?

A. No, sir, we did not consider that separately. If an allowance were made on the books for that, it would automatically be allowed for, but we did not analyze that separately to find what those payments had been, nor how they were accounted for.

Q. Do you know that there is such a charge made?

A. Yes, I know that is sometimes done.

Q. I will ask Mr. Baird how any amount paid for the installation of private branch exchanges is handled in the accounting?

By Mr. Baird:

[fol. 184] A. I presume you refer to such items as fire and police boards in Omaha?

Q. Yes.

A. That is a case where they are reimbursing us, or did at least under the old contract, reimbursing us over a period of years. I think in most of those cases we treat the amounts we receive as revenue. I am not sure how that particular item was treated. If, on the other hand, we treated it as a contribution towards the construction of a board, we would credit it back to the capital accounts. It depends on each contract or construction of the item whether it is a revenue item paid us in a lump rather than increasing the rate over the term of the board, or whether it is a direct contribution toward the construction.

Q. Well, would the figures that Mr. Granfield used be the net to the company after this credit had been given?

A. If it was a credit to construction in the book account, it would be the net.

Q. And if it was an increased rate?

A. If it was considered as revenue, even tho paid in a lump sum, it would not come into Mr. Granfield's calculations.

Q. Which is the customary method, to increase the rate or to make a contribution?

A. We have so few of them I don't think either one is customary. I recall instances of both kinds. I don't recall now which would predominate. I think I would guess that most of them are treated as revenue items. Most contributions of that sort are treated as revenue items. That doesn't apply necessarily to this account, but may apply to farm line accounts and other items of that sort.

[fol. 185] Q. Go into earnings?

A. Yes.

Q. Well then, in your study you didn't consider in each case whether there had been any compensation to the company?

By Mr. Granfield:

A. No, sir.

Q. Either through the rates or through the credit to the investment account?

A. No, sir, we did not go into that feature at all. It would not affect the service accounting at all. It might have some small bearing on the salvage, but would have no bearing on the service life.

Q. It would have a bearing on the rate?

A. Only insofar as it might affect the salvage, which I don't think would be a very large effect, because the cost of the installation is lost when we salvage the board anyway.

Q. It is customary to make a charge for installation at all your branch exchange-, I believe?

A. I don't know just what the practice is. I think that where installations are known to be temporary in character, that is in the case for instance if some large convention wants a private branch exchange for a month or so, I think there is some charge, but I don't know that that is general.

Q. In any event you aren't concerned about amounts paid to the company, whether for installation or whether it comes back through the rates?

A. No, sir, we were concerned only with the amount cap-
[fol. 186] italized, because we were working on depreciation rates which would protect the capital accounts as we found them. We assumed that the capital accounts were

set up in accordance with the Interstate Commerce Commission's regulations, and from an engineering standpoint, we didn't go back of that at all.

Q. What you were trying to find was how long the board stayed in service?

A. Yes, sir.

Q. But in getting at your investment, you didn't intend to find out whether the company was reimbursed?

A. No, sir.

Q. When these private branch exchange boards come out, they are checked up in your work shop?

A. Yes, sir.

Q. Made as good as new for operating purposes?

A. Yes, sir, if they are worth reusing, they are.

Q. What are the principal factors of depreciation in private branch exchange boards?

A. I think now the principal factor is probably changes in type. The small boards are being extensively replaced by boards with a new arrangement of keys and instruments, which are somewhat more satisfactory and economical for certain installations, and the larger boards are being replaced by automatic installations. In fact there are automatic installations available for rather small installations, and there is quite a tendency to replace the older types with newer types of service.

Q. Did you anticipate, in your calculation, that your boards under consideration were going to become obsolete?

[fol. 187] A. That was not a large factor in arriving at our answer, for the reason that private branch exchanges have a relatively short life anyway—under ten years, and while we believe that the change in type is progressively affecting the service life of the boards now in service, and change is rather gradual, and as the new types go in they become a part of the investment which this rate applies to, so that the effect is not any drastic sudden change. Of course, in addition to the effect of the design and condition of the boards themselves, there is a very large factor brought about by reason of the wide diversity of customers that we have. The businesses using private branch exchanges are not always permanent, and they are subject to growth which may cause them to require a larger installation. So that the customer's requirements are a very large factor in the private branch exchange service life.

Q. When you changed your service in Omaha from manual to dial, did you have occasion to change a great many of these private branch exchanges?

A. Yes, sir. Some of the boards then in service were modified to make them fit into the dial service, and others were displaced because it was felt they were of a type that it would not be economical to modify. That was more than ten years ago, and the effect of that change is not a dominant factor in this answer here.

Q. Do you have dial equipment in Des Moines?

A. Yes, sir.

Q. In Minneapolis?

A. Yes, sir.

[fol. 188] Q. Now, in Des Moines, did you have the same experience when you changed from Manual to Dial?

A. The same sort of experience, yes.

Q. Do you know yet what your experience will be in Minneapolis?

A. Minneapolis has had dial service for a great many years, in some exchanges in some offices, and that has gradually been extended to other offices, so that there was no sudden transition in Minneapolis in the period in which we have been making these studies. I think the first dial equipment in Minneapolis goes back to about 1916, and since then we have added an office at a time.

Q. Wouldn't your figures be influenced by the fact you have changed from manual to dial in Omaha and Des Moines?

A. The figures for the period covering the transition probably would, but that would not be a large factor, particularly on a relatively short lived plant.

Q. Would you say that these figures would have application to the exchanges in Nebraska, outside of Omaha and Des Moines?

A. You mean the rate for private branch exchanges in a small town as compared to those in a large city?

Q. Yes.

A. Just as an opinion, I would think that the smaller towns might tend to a longer service life and a lower salvage. What the net effect on the rate would be I wouldn't have any very definite opinion. The smaller towns, as you

know, have perhaps a hotel or some other institution with a private branch exchange which may last a very long time, and is usually worthless when it is removed.

[fol. 189] Q. Then you wouldn't want to say that these figures would apply to towns outside of Omaha in Nebraska?

A. I wouldn't say that we would get exactly the same answer for smaller towns studied by themselves. However, I don't think the difference would be large on the average, and I am not sure which direction it would be. As the salvage figure here is 45%, if you reduce that to practically zero you would have to have a very long service life to offset that.

Q. Would that affect the rate?

A. Yes, sir. For instance, if we assumed that in the small towns the salvage was generally zero for these long lived private branch exchanges, the service life would have to be fifteen or sixteen years to have the rate as low as it is with the average life of nine years and a salvage of 45%.

Q. I think that is all on private branch exchanges, Mr. Bollen.

By Commissioner Bollen:

Q. Mr. Granfield, I have before me the data of the Lincoln Telephone & Telegraph Company, which shows a rate of 6.4% as against yours of 7%. Do you know of any differences between your company and the Lincoln Telephone & Telegraph Company that would make that difference in the rate?

A. I am not familiar enough with their plant to have any opinion as to that, but our rate is a composite of the so-called non-multiple private branch exchanges, and the multiple private branch exchanges. I think it might be possible they have few, if any multiple private branch exchanges which take a slightly higher rate.

Q. You would have more in your institution?

[fol. 190] A. Yes, sir. Institutions like the Union Pacific and the Brandeis store, which have multiple type P. B. X. private branch exchanges. I don't know whether we have any outside of that. And the rate for those is 8.4%, while our rate for the smaller boards is 6.1%.

Q. Any other inquiries?

By Mr. Peycke:

A. I think not.

By Mr. Forbes:

Q. You may proceed to Sheet 6 and explain the results shown for booths and special fittings.

A. Booths and special fittings were studied by the turnover cycle method, just as we studied station apparatus. These booths are of several types. The so-called open type, which is just a sort of a stall with a shelf in it, and then some fairly elaborate types, with folding glass doors and electric lights in them and so on, and the older types, which were very much larger than the present ones and quite often were built in, or were really little compartments built right in the building where they were installed. The trend in recent years has been toward a more easily moveable and adaptable type of booth, and our service life studies have shown some fluctuations during the period of the study, the general trend being toward a somewhat shorter service life and a higher salvage as a result of having these boards which are more portable in character.

In the early years of the study, there were a great many of the old type of booth which were relatively fixed in their locations and were not suitable for reuse. Some of them [fol. 191] were built into the buildings and others were large cumbersome affairs that a new customer wouldn't want on the premises. So that we have based the service life and salvage on the experience relating to the more modern type of booth, which is a relatively universal sort of thing which can be installed most any place, and the salvage, as a result, runs up around 45%.

The salvage was studied in the same way as station apparatus and private branch exchanges. That is, we determined the salvage when reused and the salvage when the service life was finally determined, averaged them up, and as a result arrived at 45% salvage as a basis for depreciation in conjunction with an eight year service life.

Q. Did you inspect the booths as a basis for this study?

A. No, sir, this service life was based entirely on a history of the boards.

Q. You didn't make any attempt to find out how the condition of the property checked with its age?

A. No, sir. The depreciation studies are analyzed or made on a statistical basis relating the plant as we found it to the investment on the books.

Q. The same method you followed in private branch exchanges?

A. Yes, sir, except in private branch exchanges we have a mortality analysis which we have not been able to use on station apparatus or booths.

By Commissioner Bollen:

Q. Mr. Granfield, I have before me the Lincoln Telephone & Telegraph Company's data on this same account, and you have a service life of eight years, and they have a service life of 15.4?

[fol. 192] A. We have a service life of eight years.

Q. They have 15.4 years for the same item. Can you explain why there should be that much difference between yours and their's?

A. I could only guess. At one time, some ten or twelve years ago, the Northwestern Company had quite a large number of booths which were really little compartments built into small hotels and the like, which had a relatively long service life, but, particularly in the larger cities where we have folding door type booths in drug stores and railway stations, and so on, it is impossible to get anything like that service life and keep the customer satisfied with the appearance and type of the booth. Also, business houses, drug stores and the like change ownership or rearrange their quarters often enough so that where you have many installations of that type, the service life is bound to be lower. I am not familiar enough with the Lincoln Company's situation to know what the reason might be.

Q. They have a depreciation rate on this item of 3.8 and you have a depreciation item of 6.9. It seems to me that is quite a spread, isn't it, between two companies that are operating in the same territory?

A. Yes, sir, that is quite a spread.

Q. Can you explain it?

A. I would have to know what their figures are based on, and what installations they have. The only guess is they might have a preponderance of these compartments usually built in hotels and the like, which practically last as long as the building, and not as many of these portable

type of booths which are installed in drug stores or premises of that kind. Or it may be also that some of the [fol. 193] booths are owned by the people on the premises and not by the telephone company. I don't know anything about their situation.

Q. You are familiar with the history of that company? How they assembled their property?

A. Not very, no.

Q. You know, as a matter of fact, they were assembled about the same time your company assembled yours?

A. You mean their——

Q. I am getting at the age of the two companies. The age of these kinds of properties?

A. I don't know as to that. I didn't get into Nebraska until about 1920.

Q. I think as a matter of fact the Lincoln company was organized about 1912 or 1913, wasn't it?

A. I don't know much about the Lincoln Company's early history.

Q. Do you think that the experience that you have had will continue during the next ten years?

A. Yes, sir. I think that this will be fairly representative of what we may expect. There has been quite a change in the type of booth used, and there is much more movement of booths than was formerly the case. The booth used to be a fairly fixed property, put in a hotel maybe or railway station, and stayed there through a fairly long life, but the last seven or eight years there has been quite a change in the type of booth used—much lighter and more portable, and they are moving around more.

Q. Are you not now using a standard booth?

A. We have standard types, yes, sir, that can be set up [fol. 194] singly or in batteries of two or three, and they are readily taken down and reinstalled. The older booths were more or less permanently constructed, built into a building and there were some portable booths which took up so much more room than the ones we have now, that they had to be taken out because of space.

Q. You have discarded the larger part of those now, haven't you?

A. We have got most of them out of our accounts.

Q. The experience you have had and the studies were made on the basis of that class of booths, was it not?

A. No, sir, we have adopted the recent experience with the modern type booths as the basis for our depreciation rate.

Q. Then in the future your experience will be based on this modern type?

A. Yes, sir, this type we have now.

Q. Owing to that fact, might we not assume that the depreciation rate would be less in the future than it has been in the past?

A. I don't recall just what the rates have been in the past. The salvage is much higher, but the booth is much less permanent installation than it used to be in many ways. Particularly in the next few years when business is coming and going and booths have to be installed and taken out.

Q. How does your study compare in places like Omaha, Des Moines and Minneapolis in the way of such towns as Fremont and Norfolk?

A. I don't know off-hand. I have never made a separation of that kind that I can recall, but of course the investment in booths in a town like Fremont would be so low it wouldn't make so much difference. The larger investment in booths would be in the larger cities.

[fol. 195] Q. That would be true as to the amount of the item, but what about the depreciation rate in the larger class of towns as compared with that class of towns in this item?

A. In the larger cities I would expect to have more movement of booths than in the smaller towns. The smaller towns might have a booth in the depot or the hotel, but that's about all.

Q. If they were segregated in classes as you segregate your exchanges, it would show a much smaller per cent in the small towns?

A. Show a longer service life, but probably no salvage, and the service life would have to be almost double to make up for the salvage.

Q. When you get to the small towns, say a thousand to three thousand, would that same rule apply to them?

A. I would think the small towns, if they had any booths at all, would have the type with long life and no salvage.

By Mr. Forbes: Is it customary for your company to install booths on special occasions, such as State Fairs and

large gatherings for different purposes, where you think that there will be some toll business?

A. That is occasionally done, but the number of booths installed on occasions of that kind would be insignificant compared with the total. There might be two or three occasions a year in the territory, that would amount to anything.

Q. I was wondering whether the factor of earnings might not come into the life of the special fittings, or the booths?

A. You mean that if a booth in a certain location wasn't getting any business, we take it out?

[fol. 196] Q. No, I mean if you thought you would get some business, you would put a booth in?

A. I presume that is true.

Q. Then really you would call that a life in one position?

A. As long as it was in, yes, sir.

Q. And the compensation would have to come through the earnings?

A. Yes, sir, unless we put it in as a matter of public relations.

Q. So you considered all of the booths, regardless of where they might be installed, or under what conditions they might be installed?

A. Yes, sir.

Q. You may turn to your Sheet 7 and explain the manner of arriving at your depreciation rates and salvage, etc., for pole lines.

A. Service life for pole lines is determined from a mortality study such as I referred to in discussing private branch exchanges. A mortality study is a method of analyzing the history of retirements in relation to the plant in service, to determine the average service life resulting from that rate of mortality. The method used is similar to that used by life insurance actuaries in determining the expectancy of human beings for the purpose of determining insurance premium rates. It is the most accurate method which we have for determining average service life. It can only be applied to an account which consists of a large number of similar units, and where it is impractical to get the life history of each individual unit. The pole line account is particularly well adapted to this type of study.

To obtain the data for pole lines in a form suitable for mortality analysis, we maintain a system of records which

[fol. 197] shows not only the location of each pole which we have, with the exception of a few rural installations, quite a few rural poles, and the age of the pole, that is, the date when it was placed, and if the pole has been reset since it was originally placed, that is shown on the record. When any pole is removed, the workmen removing the pole, or the foreman of the crew, as the case may be, reports the pole that was taken out. From the records the age of that pole is determined, and that gives one item of history, that would give one pole of a given size and a certain age retired. The mortality analysis is based on the summary of thousands of items of that kind.

In exchange poles we carry currently a history of about two hundred and fifty thousand poles. At the end of each year, the mortality experience for that year is summarized, and we get a result showing so many poles retired at the age of one year or less; another number of poles retired at ages between one and two years; other poles retired at ages between three and four years and so on. We know from a summary of our records how many poles we have less than one year old. If we have, for example, fifteen hundred poles on our records less than one year old, and of those fifteen hundred which were exposed to retirement during the first year of age, we retire say fifty, then fifty fifteen hundredths would be the retirement ratio for one year old poles. We get a similar ratio for poles two years of age, three years of age, and so on. From those ratios we determine the mortality curve. In order to get a fairly large volume of data, we do not analyze results for one year, but we combine the results for three years, and that three year period we [fol. 198] refer to as a band. For example, in analyzing the experience for the band from 1920 to 1923, we would have the retirement ratio for one year old poles based on the sum of all of the one year old poles retired during the three years, to the number of poles of that age in each of the years. That is, in any study based on averages, the larger sample you have the more stable and accurate the results are. For that reason we take three year periods, to be sure of a volume of experience which gives fairly stable results.

For each succeeding band, (in fact the bands overlap), that we analyze, for example we take a band centering on 1921 and get a service life indication of say fifteen years, then take the band centering on 1932 and get a service life

of fifteen and a half, or fourteen and a half, and carry that process out for each three year period.

The pole history of the Northwestern Company we have been analyzing has been affected by the fact that beginning about 1923 we started using treated poles almost exclusively, and that meant that there were practically no one, two or three year old untreated poles on which to get history during the period subsequent to 1923. However, we have placed a great many treated poles new since that time, and as the causes which bring about retirement of poles during the first ten or twelve years of their life are not directly related to decay, we have combined the history of the treated poles since 1923 with the history of the untreated poles placed before that time. If we retire a pole today that is fifteen years old, that has to be an untreated pole because we have no treated poles that old. On the other hand, if we retire a five year old pole today, it's almost certain to be a treated pole. So the analysis on which the [fol. 199] service lives for the bands since 1923 are based include the history of both treated and untreated poles, but the indicated answer applies to untreated poles because the treated poles included in the study are of an age when the treatment was not a factor.

The service life of poles was determined separately for the Iowa and Nebraska area, and for the Minnesota and North Dakota area. The results in the Iowa and Nebraska area, prior to the time that we had treated poles, were very uniform, the average service life running pretty close to fifteen years for every band analyzed. Since the advent of treated poles, it has happened that there has been quite a fluctuation, but not due in any way to the treated poles—due to other conditions. Among these conditions were the extensive reconstruction of pole line plant, for various reasons. Toll lines were replaced to provide greater strength and room for more circuits and there were very large retirements of poles in connection with highway operations in both Iowa and Nebraska. The result of these facts was an indicated decrease in service life in the various bands since 1923 or 1924.

The service lives which we decided upon for the Iowa and Nebraska territory poles, are all of them, for all classes of poles, somewhat higher than we have been getting—quite a little higher than we realized in the latter part of the ten years ending in 1930. That increased service life

is based on the belief that the outside factors, such as highway development and growth, would not be quite as large a factor, or would not have quite as large an effect in the future as they had in the immediate past. That is the general outline of the method used for all poles.

There are factors which effect toll poles—which effect [fol. 200] the service life of toll poles which do not effect exchange poles to the same extent. One of these is the practice of resetting the poles. Exchange poles are occasionally reset or reinforced, but not to an extent that has any appreciable effect on the total service life. Toll poles, on the other hand, are quite frequently reset. Treated toll poles are not expected to be reset. They are not designed, or rather the lines are not designed to provide additional height necessary to permit resetting, and it is expected that there will be little, if any, extension of life for treated poles as a result of resetting. The untreated poles were considered separately from the treated poles in setting up depreciation rates. We have not had treated poles in the plant in any number long enough to have sufficient mortality data, or mortality data covering a sufficient number of poles of ages more than ten years, to give an indication of what the average service life of treated poles will be from a mortality analysis. However, we have had treated poles scattered throughout the territory in what are known as test sections, since about 1910. These poles are placed for observation, to provide a basis for determining what extension of life might be realized from treatment. As a result of the inspections made in these test sections, it appears that the total extension of life due to the retarding of decay by the creosote treatment was in the order of ten years. However, we can't realize the total extension of life on the average, because poles are retired for many causes other than decay, and a pole which will resist decay for ten years longer than the poles which we have had in the past will give these other factors, casualty and public [fol. 201] requirements and other outside factors, that much longer time to operate, so it seems that the maximum average life existence which we have hopes for from treatment of poles will be about eight yars. We have, accordingly, increased the average service life indicated by our analysis for untreated poles by eight years for each class of poles. That is, the average service life of treated ex-

change poles is taken as eight years more than that indicated for untreated poles. In the same way, the average service life of treated toll poles is eight years more than that for untreated poles.

Rural poles have been given a separate rate, as they are somewhat less subject to some of the factors causing retirement than the town poles, and also they get some extension of life as a result of resetting. In towns and cities, resetting is generally not practicable, as it is necessary to preserve clearances. These clearances are of less importance in rural districts and rural and toll poles are therefore frequently reset.

In determining the salvage of pole line plant, an analysis was made of the past experience. A pole that is displaced from service can rarely be used economically at another location. Unless the pole is relatively new, the cost of handling it and shipping it and perhaps storing it would soon wipe out any salvage value. The cost of removal of poles is a substantial item. The old pole has to be taken out and disposed of, particularly in cities. That sometimes is quite an expensive procedure to take down a pole in a thickly built up district and get it out without damaging anything. So the salvage of all pole line plant, in our experience has been negative. That is, the cost of removing the old pole has exceeded the value of the plant. That is our past ex- [fol. 202] perience. However, in the last few years, in the case of toll poles, some certain changes in the accounting procedure with respect to resetting of poles, has had an influence on salvage. Also some effect on service life. Formerly, when a pole was reset, from say a thirty to a twenty-five, the accounting procedure was to displace from the books the difference between the average cost of a twenty-five foot pole and that of a thirty foot pole, and charge the work of resetting, the expense of resetting, to expenses. Under the new accounting practices, when a pole is reset there is displacement of half of the investment in the pole, and the cost of resetting the pole is capitalized and not charged to expense. That new capital, representing the cost of resetting that pole, has a relatively short life—in the order of seven years. That means that that part of the investment has a shorter average service life than the remainder, and it tends to offset the effect of the extension of life obtained for the pole. The moving of lines

in connection with highway operations has had the effect of slightly increasing the salvage on toll pole lines the last few years, as many of the poles involved are treated poles, and were moved short distances and refused. The reuse of these poles resulted in an increase in the salvage, with the result that as far as toll poles are concerned in Iowa and Nebraska, treated poles, the cost of removing the poles has been about offset by the salvage for the last two or three years, and we have based this depreciation rate on that data, but I think that salvage will tend to go down rather than up in the future.

The pole line account includes not only poles, but crossarms, pole line hardware and other associated items. [fol. 203] Crossarms were studied separately on a turnover cycle basis, which indicated an average service life of slightly less than twenty years—around nineteen years as a matter of fact. That was increased to twenty in setting up the depreciation rate, on the basis that there had been some loss of crossarms in the past as a result of large line failures—the pole lines would fall and many arms would be broken. With the extension of use of treated poles, and the use of heavier poles on the lines most exposed to severe storms, we expect that there will be less of that in the future and have accordingly used a service life of twenty years instead of nineteen. I might just go into a little detail on this determination of service life by mortality study methods, and point out that that service life is the service life for poles alone. To get the service life applying to the entire account, we make an adjustment to bring the retirement ratio indicated for the poles alone, which are included in the study, into conformity with the retirement ratio as shown on the books for the entire account. That adjustment is applied to the mortality curve, and gives the indicated life of the pole and associated items, and weights in the effect of the relatively few poles in most classes which are not represented in the studies. That is just a brief outline of the study of poles. It requires the handling of a tremendous volume of data. You can readily see that carrying on the history of two hundred and fifty thousand individual items, for exchange poles alone, and probably a large number for toll poles, runs into a very large volume of paper work, and the results are finally concentrated into relatively few data sheets, and when the supporting data for these

[fol. 204] schedules are finally prepared in presentable form, the concentrated summaries of these data will be included, as well as all of the calculations. I probably went over some of the detailed items, but there is such a volume of detail in all of the various varieties of poles in the account, that it is rather difficult to give a complete description in a relatively few words. The final depreciation rate for poles is a composite of the individual rates for each type of pole, based on the investment as of the first of this year. I think it is a fair statement to say that individual histories of literally millions of poles have been considered in arriving at these service life indications.

Q. How far back does your record go?

A. The records, in the form which we now maintain them, have been kept since about 1924, I should say. Records prior to that time had to — built up by an analysis of history from other records which were not originally set up with the idea of providing mortality data. In our research into the old records, we went back and included poles which were placed in the nineties, and carried their history through. The bands which we have analyzed for poles in general comprise about the last fifteen years, I should say—the bands on which we base these answers—although in those fifteen years we recorded the mortality of many poles placed twenty-five or thirty years ago.

Q. When a pole was displaced at the time you began your record, say ten years ago, how could you tell whether that pole was ten years old or twenty years old?

A. When the records were set up, the town poles in most of the exchanges, and the toll poles in practically all the toll [fol. 205] lines, were considered individually, and the date of installation assigned where there was reasonable bases for determining the age. For example, a toll line was known to have been built between two points in 1907. The toll poles have been numbered by this company for many years, so that we had a record of toll poles by numbers. It has been the practice of the Northwestern Company for many years to periodically inspect these toll lines, and these inspectors would designate certain poles that had rotted to a point where they should be replaced. These inspectors are quite familiar with the lines, and they made records of the inspections, and from that information it was generally possible to assign ages within a high degree of accuracy, to

say 90% of the poles in that toll line. Poles on which the history seems to be very obscure, and wouldn't give any basis for assigning the age or date of installation, were just carried in the records as unknown. When these poles are retired, they have no effect on the mortality studies, because we can't get the information.

Q. You made an effort to date the poles set in toll lines?

A. Yes, sir.

Q. What did you do about exchanges?

A. In exchanges we first assembled all the estimates and work prints and similar plant records that were in our files. We analyzed those in connection with the map records which we then had, showing the location of poles in the city. Each estimate covering a section of town was reviewed, and the history of poles traced as accurately as possible, by comparing estimate prints, job order prints and the like with [fol. 206] the map records of the town or section of town in which the work had been done. I happened to remember reviewing the study of all plant records in Omaha and as I recall it, there were some sixty or seventy maps more than four feet square, which had been built up showing the history of all the poles that were ever in each section, insofar as that history could be taken off of these estimate prints. Those prints, and the summary of the data on which they were based, were the bases for assigning ages to the poles in Omaha, and those maps and records that they are made from, are retained in our Nebraska area files as support for the initial records.

Q. You have maps of all your exchanges in this state?

A. Nearly all of the exchanges were covered by this sort of a study. Some of the exchanges, it was impossible to get very much that could be relied upon in the way of old history, but it so happened that many of those exchanges had plant that was so old at that time that there is very little of it left now, so that in many cases, exchanges in which we could set up nothing in the way of historical records in 1924, might now have very complete records, as most of the plant dates since 1924 at the present time. I think at the present time something over 90% of our town poles are dated. We know the age of better than 90% of the poles we now have in towns. Rural poles have been more difficult to study.

Q. Then I take it you had to make an estimate, in a large number of poles, of the age, at the time they were retired?

A. If the age had not been recorded in the records before the pole was retired, no estimate was made after the pole [fol. 207] was retired. In building up the records, undoubtedly there was a certain amount of estimating of the age of the older poles, but unless there was a good basis for that estimate, unless it was supported by some very plausible evidence, no date was assigned to the pole, and it was carried as a pole of unknown age.

Q. Now I take it that your records are more complete on the poles that have been retired in the last ten years?

A. Well, you mean the records of retirements in the last ten years is more complete than the record of retirements prior to that time?

Q. Yes.

A. That is undoubtedly true. That is one of the reasons why the mortality study is such a useful tool in determining the service life of poles, because if we know nothing at all about any history of poles prior to even five years ago, if we have the age of all the poles being currently retired, we can determine the average service life with a high degree of accuracy. It is just similar to a life insurance company coming into a town like Lincoln, for example, and assuming there is no such thing as a mortality table—no one had information as to the average life of individuals. If they started out with a record of the ages of a large number of the people in Lincoln, and then made a record of all the deaths that took place from people of all ages over a period of four or five years, assuming there are enough individuals to make a good sample, they could analyze those mortality data for that period of five years and determine the average expectancy of individuals just as accurately as if they had been keeping those records since the [fol. 208] town was originally founded, because the ratio of retirement to the amount of plant or number of people exposed to retirement at a certain age, is the basic factor in determining the service life by the mortality method.

Q. Wouldn't the records have to be kept, for insurance purposes, long enough to show the life of the oldest person?

A. No, sir, they do not. All they have to do is know what proportion of people of any or all ages would be expected to die at that age. They have to know what per cent of people that are now 30 years old will die before they

are 31, what percent now 31 will die before they are 32, and so on. If they get that sort of information over a period of three or four years, they can build up accurate mortality curves, and I believe that they—it is my impression they make that sort of analyses every year and get their mortality rate by years, and then they can tell something about the trends from year to year, or period to period.

At this point a ten minute recess was taken, after which the taking of testimony was resumed as follows:

By Mr. Forbes:

Q. Did you mean the record would not have to have been kept from the time the oldest person was born up to date?

A. That was the way I interpret it. The records would, of course, have to record the mortality of the oldest person. You would have to have records of their age at the time they died, and the same way we have to have records [fol. 209] of the very old poles that are now in our plant, and we do have the record of the very old poles, so we can get the record of the twenty-five or thirty year old poles that have yet to be retired, just as we are getting the record of the ten or twelve year old poles that have been retired.

Q. I would like to know now what information you have on those older poles, except from these estimates?

A. If we have in Omaha, for example, a line of poles that may have been in since 1910, those poles are shown on our records as 1910 poles. If they are retired today, that would be the retirement of a twenty-three or twenty-four year old pole. That date of 1910 which appears on the records associated with that pole, was determined by research of the estimates and jobs done in 1910, and where that pole is located.

Q. Does your study contemplate the life of a pole in one position only?

A. Yes, sir, the accounts are set up on the basis of life in one location. The reset life is carried separately, and an adjustment made for it.

Q. Then a pole that serves a year in one position, or one location, may serve two years in another location and three years in another location?

A. It might. But not many poles are reused in new locations and not reset in the same location by sawing them

off and lowering them into the same hole, at least relatively few are. When they are reused in a new location, they are handled as tho they were new poles, and the salvage is set up on that same basis—salvage in the amount of the cost of a new pole of similar dimensions is credited [fol. 210] to the accounts, and that pole starts off just like a new pole in our records. However, that is not a large factor in our operations. The reuse of poles in different locations is not a large item.

Q. That does happen, tho?

A. It does happen and it has happened, as I mentioned. In connection with salvage. It has happened to a greater degree than usual during the past few years, with respect to treated poles that were involved in highway rearrangements, and that has operated to increase the salvage from something substantially below zero to about zero.

Q. When a pole is removed from plant and later set in a new location, it is charged into plant as a new pole?

A. Yes, sir, and the salvage credit is also at the cost of a new pole.

Q. What is the charge to depreciation there?

A. The charge to depreciation would be the difference between the cost of that pole originally set, which would include the cost of the material and handling and the labor of placing the pole, the difference between that amount and the value of that pole when it was salvaged, based on current prices, would be the amount charged to depreciation reserve. It might be around half of the cost of the pole.

Q. Expand on that, will you please, I am not exactly clear on it?

A. Well, the amount shown on our books for a pole is made up of the cost of the pole, including freight and handling charges on the pole from the woods up to the point where it is placed, and the labor in digging the hole and placing the pole is also capitalized and included in the [fol. 211] cost of the pole in place which appears on our books. If that pole is removed and used someplace else, all that can be salvaged in the way of gross salvage, is the cost of a similar pole at the time it was taken out, and the cost of removal is deducted from the gross salvage to arrive at the net salvage.

Q. The original cost of the pole, or what you consider the salvage cost of the pole?

A. The amount of gross salvage is determined by the cost of a pole of those dimensions at the time it was taken out, regardless of what it cost when it went in.

Q. If we assume a pole in place cost $10.00, material is $8.00, the cost of installation being $2.00, the $2.00 plus the cost of removal plus the difference between the salvage value and the cost new, is charged to depreciation?

A. The difference between the salvage value and the cost new of the pole, yes. That might be in either direction, yes, sir.

Q. I would like to have the record show that clearly. If you prefer to make your own statement, I would be glad to have you do it.

A. The charge to depreciation when a pole is removed from plant and reused in another location is equal to the difference between the cost of the pole on the books, which includes labor of placing, handling charges, etc., plus the cost of removal, and the value of a pole of that size at the time it is taken out.

Q. Then the difference between the salvage value of the pole, and its cost new at the time of removal is a charge to depreciation at that time?

A. Yes, sir, net salvage.

[fol. 212] Q. The pole is put back into plant as a new pole?

A. Yes, sir.

Q. If it serves its life in one position after that, what do you do then?

A. When it's retired, assuming that it is not suitable for any further reuse, there will be a displacement of the entire book costs of the pole and an additional charge to depreciation equal to the cost of removing the old pole.

Q. Are these poles that are moved kept in a separate class by themselves?

A. Poles that are moved and reused in another location, no, sir, they are not kept separately. A pole that is reset in the same location is identified as such on the records.

Q. What's the separation in the bookeeping entries when a pole is removed and abandoned or discarded?

A. If the pole is removed without any salvage, the books are charged with the retirement of the installed cost of the pole and the depreciation reserve is also charged with the cost of removing the pole.

Q. How about the difference between cost new and the salvage value of the pole, isn't that charged to reserve?

A. I thought the case you were referring to was a case where there was no salvage.

Q. Yes, now that is the same pole we have been talking about. It serves its second position in the plant. I don't see why you are not charging a part of that pole to reserve twice, the whole pole one time and part of the pole another time?

A. Well, it goes through the reserve accounting twice, the [fol. 213] same pole does, but by accounting for the salvage, there is no cumulative charge to the reserve.

Q. Is the salvage value the cost of the pole new when it is first removed?

A. The salvage value when a pole is taken out for reuse is the cost of a new pole.

Q. So that you only make one charge on account of the timber to the reserve?

A. Yes, sir.

Q. Now, in making your calculations, you naturally have a large number of short lived poles on which you have definite information?

A. Yes, sir, quite a few short lived poles.

Q. And your definite information would stand up, you say, to about fourteen years, 1920?

A. We had some history going back much further than that. We had history of poles back into the nineties. We did not have a complete record of the poles which were placed in the nineties and the early nineteen hundreds and were retired at an early age, because we didn't have any record of short lived retirements in those days. But we did have a record of the older retirements from the poles placed in those periods.

Q. Now, let's take a pole that is cut off—thirty-five foot pole reset as a thirty—what's the operation?

A. When a pole is reset, you mean the accounting operation?

Q. Yes.

A. The present accounting calls for the retirement of about half of the investment in a thirty-five foot pole. [fol. 214] That represents the cost of placing the pole and the value of the butt of the pole which is cut off. That amount is charged off through the depreciation reserve

when the pole is reset. The cost of resetting the pole is capitalized. That takes the place of the investment in setting, which was displaced.

Q. How long have you been doing that?

A. That has been done only since the new system of accounts went into effect last year.

Q. What did you do before that?

A. Before that the procedure was to charge to the reserve the difference between the average cost of a thirty-five and a thirty and perform the resetting operation under expense charges.

Q. That would be true of a third setting, or might be?

A. Yes, sir, any number of resettings would be handled on the same basis as the first.

Q. What consideration did you give in your study here to reset poles?

A. The effect of resetting is reflected in the untreated poles which are the only poles which we expect to reset. That adjustment was made by analyzing—by mortality study method—the average service life of reset poles. Then we determined the percentage of the untreated poles which we might expect to reset. That percentage was applied to the average extension of life resulting from resetting, and the new accounting procedure with respect to new capital resulting from resetting, was taken into the calculation and the result and addition in life was added to the average service life of the original length, to give the total service life in one location, which was used as a basis for depreciation rates.

[fol. 215] Q. Now with reference to the old poles, the very old poles that you took into consideration, did you have any record there to show, or did you assume they had been reset, or what arrangement did you make for those?

A. Our records would show whether they were reset, even the oldest poles, because the records from which the ages were determined specified the length of pole placed, when it was originally set, and if the pole now is of a different length than was originally placed, as shown by the work report of the original job, we would know it had been reset.

Q. And you assumed that it had been reset?

A. Only if the length of the pole now was different from the length of the pole originally reported. Generally it is

not different in exchange poles, as resetting has never been done extensively in towns by the Northwestern Company.

Q. Did you find that the life in towns was shorter than the lives in rural districts?

A. Yes, there is a slightly longer life for rural poles.

Q. Did you make any separation between the large towns and the small ones?

A. No, town poles are all combined and rural poles are combined.

Q. You expect to get eight years more life from the poles treated as they are now, than the poles originally set up?

A. Yes, sir.

Q. Are you setting any all treated poles?

A. Yes, sir.

Q. Setting those in toll poles lines or exchanges?

A. Both, but mostly in toll lines. They are sometimes [fol. 216] objected to in exchanges.

Q. Now you testified you took out property from plant at what—cost?

A. Original cost is averaged for poles in what is called cumulative retirement units.

Q. I want to know about those retirements units. How are they made up?

A. Those units are made up for each individual exchange by distributing the total investment in poles over the various sizes of poles in the exchange, on the basis of the normal differential in cost between poles of various lengths. These retirement unit costs, for all of the poles in the exchange, total to exactly the amount shown on the books for the total account.

Q. Do I understand that you have a displacement unit for each size of pole?

A. Each length of pole.

Q. How often are these displacement units revised?

A. They are revised every year, unless there has been no appreciable amount of construction done in a given exchange in a certain year. By and large, I think it is an accurate statement to say that during all the period covered by these studies, the cumulative retirement unit costs have been revised annually.

Q. What would be the effect, if you didn't keep your displacement units up to date?

A. If your displacement units were not currently kept in accordance with your current accounts, displacements might be inaccurate. It might be possible, for example, to displace all the poles and still have some money left on the [fol. 217] books, on the retirement books, from not keeping them currently adjusted to the actual costs.

Q. Might result in charging too much to the reserve?

A. Might result in charging too much to the reserve or too little.

Q. Might result in removing too much from plant or too little?

A. It might, yes, sir.

Q. Are you sure these units are kept up each year for each exchange?

A. Yes, sir. I think in some small exchanges, it is intended to make no revision when there is no change in investment. What I have in mind, is this. As I recall it, our practice was to issue a complete new set of retirement units every year. I think the practice now is to check each exchange, and if there has been no change in retirement units during the year, a new sheet will not be issued, but the exchange will be checked nevertheless, so that the units, if they are not correct, will be changed.

Q. What do you do about purchased property?

A. Purchased property is set up on our books in accordance with the same plans we follow for our own, and the retirement units would be based on whatever was capitalized in connection with the property.

Q. Does a crossarm go out with a pole, ordinarily?

A. Not necessarily. Crossarms are subject to some things that poles are not, and vice versa. If a wire plant is displaced by cable, the same poles may be used and the crossarms stripped off. New crossarms might be retained in service when the old poles to which they are attached are taken out of service. In the last few years there has been a new type of crossarm used on lines designed for carrying circuits at a different spacing and do not provide [fol. 218] for phantom circuits. That crossarm might displace a standard type of crossarm, because of the requirements for the different types of circuits, whereas the pole would not be affected at all by that change.

Q. How did you handle the depreciation on crossarms?

A. The average service life of crossarms was determined from a turn-over cycle study of units. In order to avoid the necessity for making allowance for change in price levels, we made the turn-over cycle on the basis of the number of crossarms, counted back the number of crossarms retired each year until we arrived at a point where the accumulative retirements equaled the number of crossarms in service.

Q. What effect did you give to change in price levels?

A. By using the crossarm units, we did not and do not consider prices at all, because we base the calculation on the number of crossarms. That eliminated any price factor at all.

Q. The life of the pole is getting longer. Is the life of crossarms getting longer?

A. I think that in the past crossarms have had a little longer life than untreated poles. However, in the future, I expect that they will have a shorter life than treated poles, and maybe a shorter life than they have had in the past, if the program for placement of long cables advances very rapidly.

Q. You refer now to toll cable?

A. Yes, sir.

Q. How about the exchange crossarms?

A. Exchange crossarms are not as much a factor in the investment as they were ten or twelve years ago, as the [fol. 219] practice of using cable has been extended to a point where open wire circuits on crossarms are not very numerous in exchanges.

Q. Wouldn't it be natural to conclude that with the lengthening of the life of poles, that the length of the life of crossarms would also increase?

A. The pole life is being lengthened principally by treatment. The crossarms that we used are largely untreated, untreated fir crossarms. I would not expect the increasing of the life of the poles to have any substantial effect on the life of the crossarms. On the other hand, there are factors coming into the picture now which would tend to shorten the life of crossarms, and there is nothing to lengthen it.

Q. You mean by the increased use of cable?

A. Increased use of cable, and in the case of toll lines, the use of a different type of crossarm.

Q. Wasn't it the practice, in years gone by, to abandon the crossarms and pole line hardware at the time the pole was removed?

A. That may have been the practice some time ago, but for all of the time I have had any personal knowledge of it, there have been any number of crossarms transferred to new poles from the old poles.

Q. Your annual percentage rate for poles and crossarms in Iowa and Nebraska is less than it is in Minnesota and North Dakota?

A. The depreciation rate is slightly higher. The service life is less in Nebraska and Iowa.

Q. I have reference to your annual percentage rate here of 4.7 for Iowa and Nebraska properties, compared with the 5% for the total investment.

[fol. 220] A. That is due to the fact that there is a larger percentage of treated poles in Iowa and Nebraska than there is in Minnesota and North Dakota.

Q. But you do use a composite rate of 5% for Iowa and Nebraska when your calculation shows 4.7%?

A. When these rates are applied to these figures, we apply the component rates. We don't apply the composite. This composite calculated here was in accordance with this schedule required by the Interstate Commerce Commission, but it is my understanding that we are still setting up our books on the basis of the component rates.

Q. And not the composite?

A. And not the composite. The composite would vary with the investment. Now whether that will be changed by the present accounting rules, I don't know.

Q. Well, then, we understand that you gave separate consideration for Iowa and Nebraska properties, in finding your depreciation?

A. Yes, sir, in the case of toll poles, not exchange plant.

Q. You have used a composite rate on the exchange plant?

A. We use the same rate in all classes of property of exchange plant.

By Commissioner Bollen:

Q. I notice, Mr. Granfield, in your Sheet 7, Schedule 2, your net salvage values all show a minus percent. I assume from that that the cost of removing the pole is more than the actual value of the pole as it is removed?

A. Yes, sir, very substantially more.

Q. Is that fact reflected in the annual percentage rates?

[fol. 221] A. Yes, sir. By decreasing that salvage, you automatically increase the rate.

Q. I have before me the identical data for the Lincoln Telephone & Telegraph Company, and they show a net salvage value of 11.5% plus for toll and 2.3% plus for exchange. Can you explain how they can get more salvage value out of a poll than you can?

A. No, sir, I don't know what would result in that. I know that with the experience of the last two or three years, when we have had to move some very new treated poles, our salvage has been higher but substantially below zero.

Q. Well, isn't it possible to get some farmer to take that pole out for the pole, when you get through with it, without any minus cost to the company?

A. Not as a general proposition, no, not in most of the territory we operate in. For instance, if we take a pole down in Omaha, nobody in the city wants a pole of that size. If we saw it up for them, they might take it for kindling wood, but the cost of hauling the pole around the city is a considerable cost.

Q. I was thinking about the toll business in the smaller town exchanges?

A. I think we have occasionally been able to dispose of a few poles by having the farmer take them, but the most that would be expected would be a nominal charge of ten or twenty-five cents per pole, and unless the poles are fairly close to the farmers property, I don't know that we could dispose of very many of them that way; and if we did get that much for them, we couldn't begin to take the average pole out of service for twenty-five cents—get the pole out of the ground.

[fol. 222] Q. I assume it would take some expense to find the farmer to take the pole?

A. It might.

Q. But in case you did, you would have the hole to start with on the new pole, if you didn't fill it up?

A. Yes, but the cost in that case, the saving, might not be large. In the toll work, we generally use a boring machine, and we have to have a machine out there anyway, and even if we did attempt to save the hole, we would have

to bore it out; and in many of the parts of Nebraska where we have toll lines, the farmers are quite a ways apart.

Q. At this time may I inquire if you have your Nebraska properties segregated from the total?

A. In the case of toll poles, we have Nebraska, Iowa and South Dakota combined separated from Minnesota and North Dakota, combined. We haven't the data for Nebraska by itself.

Q. Well, don't you have an inventory of your Nebraska poles?

A. Our records are kept by individual exchanges, and those records were summarized in that hearing last spring, to give an idea——

Q. I am wondering if you can't furnish us this same exhibit, in which you segregated your Nebraska plant investments?

A. The investment, yes, sir.

Q. In right-of-way, buildings and poles?

A. Yes, sir, that——

Q. How long would it take you to do that?

A. I will ask Mr. Teal how much of a clerical job it would be to make this sort of an exhibit, changing the investment figures to Nebraska figures and recomputing the composite on that basis.

[fol. 223] By Mr. Peycke:

Q. For pole lines alone?

By Commissioner Bollen: Everything—all depreciable property.

By Mr. Teal:

A. I think the investment figures are available so that that could be done in a few days, or a week.

By Commissioner Bollen:

Q. Could we have it within the next six or seven days?

A. I think so.

By Commissioner Bollen: Let the record show they will furnish that, and let the record also show it is admitted.

Exhibit *exhibit* will be furnished by the Northwestern Bell Telephone Company, and when received will be attached and marked Exhibit No. 2, as follows:

[fol. 224] EXHIBIT No. 2

Northwestern Bell Telephone Company

State of Nebraska

Schedule of Property

Included in Telephone Plant Accounts as of January 1, 1934

and

Depreciation Percentages for Use During the Year 1934

Primary Accounts Covering Depreciable Property		Ledger Value (January 1, 1934)	Depreciation Rates	Estimated Annual Depreciation Charge (See note below)
No.	Title			
	(1)	(2)	(3)#	(4)
207	Right of Way	$49,485.57	2.6	$1,287
212	Buildings	3,390,519.21	2.6	88,154
221	Central Office Equipment	6,445,478.97	5.1	328,719
231	Station Apparatus	1,677,229.89	6.4	107,343
234	Private Branch Exchanges	430,830.94	7.0	30,158
235	Booths & Special Fittings	86,572.64	6.9	5,974
241	Pole Lines	4,235,445.69	5.0	211,772
242	Cable	3,798,869.61	3.6	136,759
243	Aerial Wire	2,850,068.70	3.6	102,602
244	Underground Conduit	1,116,463.27	2.0	22,329
261	Furniture & Office Equipment	332,024.27	6.9	22,910
264	Vehicles and Other Work Equipment	247,035.80	17.6	43,478
	Total—Depreciable Accounts	24,660,024.06	....	1,101,485

Estimated annual composite rate of depreciation for all depreciable accounts—determined by dividing the total estimated depreciation charges shown in column (4) by the total ledger value of all depreciable accounts shown in column (2) 4.47%

Note: The amounts shown in column (4) were determined by multiplying the accounts in column (2) by the rates shown in column (3). The actual charges for the year will be more or less than the amounts shown in column (4) depending on the fluctuation in the plant account during the year.

Based on composition of plant in Nebraska in each primary account Jan. 1, 1934.

fols. 225 & 226] Northwestern Bell Telephone Company

State of Nebraska

Schedule of Property
Included in Telephone Plant Accounts as of January 1, 1934
and
Depreciation Percentages for Use During the Year 1934

No.	Primary Accounts Covering Non-Depreciable Property — Title (1)	Ledger Value (January 1, 1934) (2)
201	Organization	$26,932.59
202	Franchises	.....
203	Patent Rights	.....
211	Land	334,586.56
232	Station Installations	729,006.36
233	Drops and Block Wires	577,712.18
276	Telephone plant purchased	.....
277	Telephone plant sold	.....
278	Undistributed cost of property	9,763.74
280	Construction work in progress	52,994.84
	Total Non-depreciable accounts	1,730,996.27
	Total ledger value—All plant accounts	26,391,020.33

Estimated annual composite rate of depreciation for all plant accounts—determined by dividing the total estimated depreciation charges shown in column (4) sheet 1 by the total ledger value of all plant accounts shown in column (2) above 4.17%

[fol. 227] By Commissioner Bolien: Are there any other inquiries? If not, you may proceed to the next item, Mr. Forbes.

By Mr. Forbes:

Q. Referring to Sheet 8, your Exhibit 1, showing the depreciation rate and salvage, etc., of cable. Will you explain that?

A. The primary cable account is made up of quite a number of sub-accounts, each sub-account applying to a type of plant that has some definite difference from the others. The exchange aerial cable and the exchange underground main cable are the two most important items in the account.

For each of these classes of plant, the service lives were determined from mortality studies of the same type used for poles. The other accounts include toll aerial cable—entrance. Those cables are cables which connect the open wire toll lines with the exchange, and they have some characteristics which distinguish them from exchange aerial cable, but those characteristics are not of any importance

in connection with service life and salvage, so those cables have been given the same life and salvage of ordinary cables.

Then we have toll aerial intercity cables, which are long cables between cities, and as we have none in Nebraska, I will just pass over those. We have those in Iowa and Minnesota.

In addition to the underground main cable, we have what we call underground subsidiary cable. Those are cables extending from main cables to outlet poles, etc. They differ substantially from the main cables and have an appreciably shorter service life.

[fol. 228] We have toll underground entrance cables, which are underground cables carrying toll circuits from open wire into the offices, and in that account is included a substantial investment in the loading coils.

Toll underground inter-city cable is not a factor in Nebraska. We only have one of those cables, and that is in Iowa.

Submarine cable, we have one across the Missouri River at Sioux City, but only part of it is in Nebraska, and it is a small item so I will pass over that.

Exchange aerial cable and exchange underground cable are the two important items in that account. The exchange aerial cable life is determined from mortality analyses for various periods, going back to 1912 or 1913, show a distinct tendency to increase for the first few years studies. After cable plants became more stable, the retirements at early ages were reduced. Then during the war period, the retirement of cable was very much reduced, because of the fact that service was curtailed, and after the war it was impossible to get as much cable as we needed, so that the old cable had to serve until new was available, so that period showed a tendency toward longer life. Subsequent to that period the service life again began to decline, as inadequate cables were replaced with larger costs. During the last few years, that effect has not been present. We have used for the service life in determining this depreciation rate for aerial cable, a slightly longer service life than we have realized in the last few years, on the theory that growth will be retarded somewhat for a few years, and give this cable a little longer period of service.

The salvage for cable is determined from what is known [fol. 229] as a historical cost study. If we based our salvage on the actual salvage realized at the distress prices which have prevailed for the last two or three years, we would show virtually no salvage, because the cost of junk material was so low that it would hardly do much more than realize the cost of removal. So we have based salvage on a study from which we determined the average cost to us of all of the copper and lead in the cables which we now have in plant. We arrived at that by determining, from our mortality study information, how much of the present cable was placed at different price levels of copper and lead, and then averaging the results for the total plant. The historical cost of the metals related to the book cost of the plant now on the books, is used as a basis for arriving at this salvage figure. The ratio of salvage value to the cost of the cable, the average cost of removal, and the average cost of getting the metal to the refineries was considered. The result was a salvage of 7%, based on the assumption that in the long run, the salvage will follow the historical average cost. If metal prices stay at a low level for several years, this historical figure will very gradually come down, and for several years the salvage realized would be very much less than the salvage determined by this method, but the method was employed as the only alternative. Two alternatives would be to take salvage at the present market price, which would result in a very low salvage, or to try to predict what the prices were going to be when we did salvage copper. Instead of doing either of those, we have taken the historical cost of all the copper and lead in our cable, which has been bought over a period of twenty-odd years, some going [fol. 230] back further than that probably, and used that as a basis for figuring depreciation. We have done the same with all the cable accounts.

The service life of underground main cable was determined by mortality studies. The last experience we have indicates the service life in the order of thirty years. The Northwestern Company has been fortunate in the past, in that most of its large cities had very adequate duct space, so that the cables that were placed years ago, and have a relatively small number of pairs in a sheath compared to what we have now, were very rarely forced out of the ducts

by the requirement for more pairs, which necessitated another cable in the same duct, as there has been enough duct space so that it has been possible to add another cable in another duct without removing the small cable. Part of that duct space was acquired through purchases of competing properties—such as in Omaha. During the past ten years, that duct space has been pretty well filled up, so that growth in the future will probably force cables out of the duct to make room for a cable of greater capacity in the same duct space. However, as the growth demands as a result of growth have not been heavy for the last three or four years, we have set up this rate on a service life of thirty-two years, which is somewhat longer than any of our experience indicates. Not much longer, but somewhat. We, after reviewing all those studies, have very definite ideas that we might get slightly more than thirty years, but we don't hope to get as high as thirty-five, so we have taken thirty-two years, which is slightly longer than our experience even in the last band of practically no growth shows, as the basis for this depreciation rate.

[fol. 231] Now, subsidiary cable has a much shorter life than main cable because it is mostly shorter in length, running from the main cable to a pole or a building. The pole is subject to being moved, the buildings are changed around, and the terminal boxes, which are quite expensive, are being removed due to changes in cable practices. Those terminal boxes provided fuse protection which would not be necessary when the cable plant, consisting of the large gauge wire is replaced. We are now using a small gauge cable which does not require fuses and protection against lightening because the fine wire will fuse itself. The result is, we have displaced a large number of these expensive protection boxes. The result has been that the service life of subsidiary cable is about two-thirds that of underground cable. There is no salvage, as these boxes are worthless when they are removed, and the short length of cable does not lend itself to reuse, and the cost of the removal is a bigger percentage of the value of the plant.

Another fact considered in determining salvage was the percent of reuse of the cable—the maximum salvage that we could get from our cable would result if we used again all the cable in plant when it is retired. The minimum salvage would result if we junk it all. A study was made for

each type of cable by the engineers in each area. The study was directed to all sizes and classes of cable, and based on experience in the past in the reusing of cable, together with the experience of that reuse, and indications as to the desirability of continuing the reuse. As a result of that survey, the percentage of the cable now in plant [fol. 232] which it is expected it will be economical to reuse was determined, and that cable was included as salvage in the cost of new cable, the average cost of cable. In the case of aerial cable, the reuse will be negligible. Cable reused aerially in the past has caused a great deal of trouble, handling the old cable brings about cracks that are very small and they cause very serious trouble which is hard to locate. Also, cable is cheaper per foot than it once was, and there is less to be gained by reusing cable. The result is, the reuse of cable in the future will be relatively a small item, and will be negligible for aerial cable. That general review is an outline of what we did in general on the cable accounts, to arrive at these depreciation rates.

At this point adjournment was taken until 1:30 o'clock P. M., at which time the taking of testimony was resumed as follows:

By Mr. Forbes:

Q. What are the factors in depreciation that affect cable?

A. The principal factors are inadequacy as a result of requirements for more facilities than are available in the existing cables, to some extent change in design of cables, change in distribution arrangements resulting from street rearrangements or from joint construction with power companies; and in the case of underground cable, occasional loss from electrolysis; to a limited extent to wear and tear, on aerial cables sometimes due to cuts by rings to an extent that it requires some replacement. Those are the principal factors that I can recall offhand.

[fol. 233] Q. Growth is what you mean by inadequacy?

A. Inadequacy generally results from growth.

Q. When cable is installed new, it is customary to provide for some growth, isn't it?

A. Yes, sir.

Q. And as the use of the pairs approaches the capacity of the cable, then you think of changing, do you not?

A. We change the cable frequently, yes, sir.

Q. How much reserve capacity do you consider it necessary to have in a new cable?

A. That varies with the situation that is being considered. I don't know that we have any definite standard. Sometimes, the nature of the district being served, the provision for growth would have to be much larger than in other cases. I think that generally is a matter of individual treatment.

Q. Putting in cable in a settled district, apparently built up as far as phones are concerned in the near future, would you consider any additional capacity necessary?

A. There should always be some additional capacity to permit having spare pairs in case of trouble, but from a growth standpoint alone, the provision of additional pairs would ordinarily depend upon a review made of the locality to be served, before the cable was placed, and an estimate of some kind would have been furnished the engineer, so that he would know about what the growth prospects were considered to be.

Q. In building out into a new addition, you would have a large reserve of capacity?

A. We might have, yes, sir.

[fol. 234] Q. Now, following the development of the telephone service in Nebraska during the ten years preceding 1929, when new cable was installed, it was customary to provide for the necessary capacity for growth.

A. Yes, sir.

Q. Was there much of that done?

A. Much new cable placed at that time?

Q. Yes.

A. Yes, sir. From 1924 to 1928 there was a great deal of new cable placed.

Q. Was that done for still another reason? Wasn't it a fact that a new cable came into the field that improved on the old one?

A. Yes, but so far as the exchange service was concerned, the improved cable usually resulted in a more economical job of replacement, rather than in forcing the old cable out of the picture. The improvements in transmission and cross-talk features of cable are only occasionally important enough factors in the exchange plant to justify removing existing cable, when there are no other factors involved.

Q. And the life of the new cable was longer than the old cable?

A. Some.

Q. From a physical point of view?

A. I wouldn't expect very much difference. The sheath on the new cable is generally thinner, to save metal. There have been some advances in design of rings and the suspension of cable, which would offset the effect of the thinner sheath. While the new cable would probably be freer from trouble, I don't know that its over-all life would be very [fol. 235] much different from the old cable, if we are talking about old cable of the type used by the Bell System Companies for quite a few years. There is a type of cable that is quite old, sometimes called a pure lead sheath cable, which had a short physical life, but that type of cable was practically eliminated from the Bell System plant ten years ago. We had very little of it left even then.

Q. Does your study go back far enough to include the old lead sheath cable?

A. We go back to a period in which there was a substantial amount of lead sheath cable. Whether or not that was originally Bell placed cable or purchased cable, I don't know. Since I have been in the business, the Bell companies have placed no pure lead sheath cable. It has all been alloyed sheath.

Q. But you removed a lot of cable of that kind, did you not?

A. Yes, sir, particularly purchased cable, and the effect of the displacement of that purchased cable is not reflected in our results here. We displaced quite a little of that in Minneapolis after the consolidation of the plants up there, but that displacement, as well as the displacement of the cable acquired from the independent company in Omaha some twenty years ago, is not included in our studies, as representative of our own experience.

Q. Does your study go back as far as 1924, when you say that substantial replacements were made?

A. Our studies go back to about 1912, in considerable detail.

Q. But it does include——

A. It includes all——

Q. All of that period of replacement of cable?

A. Yes, sir, and the service life obtained during that [fol. 236] period is considerably shorter than we are using here for the future.

Q. Now, how did you arrive at this service life, not having included the old type of cable?

A. We made studies which indicated the service life for each three year band. The three year band following 1924 indicated a shorter service life than the period preceding it. The three year band ending in 1932 indicated a longer service life than the preceding period. This service life here is slightly increased over the results of the last three year period, when the element of growth was not a large factor.

Q. When all these changes in cable plant were made, capacity for future growth was provided in the cable you speak of?

A. Yes, sir, a moderate amount. A very rapid growth in exchange requirements has never been experienced or estimated in our territory.

Q. When did you complete this study you have made?

A. This study was completed in this form in the early part of this year. It was the extension and bringing up to date of studies which we have been making currently for the last seven or eight years.

Q. What do you think now, looking forward, is the prospect for depreciation on account of growth in the telephone cable?

A. I think that growth will continue to be a factor, but that in the next three or four years that factor will be of little more importance than it has in the last three.

Q. You think that these tables will apply in the future as well as they have in the past?

A. Yes, sir. This table is made up with that intention. [fol. 237] The service life that we are using here is somewhat more than our past experience indicates, even more than that indicated by the last few years analyzed, in which the growth was not a factor of any consequence.

Q. When you install underground conduit, you make provision for long life in the future, do you not?

A. Generally speaking, we do, but we have had to reinforce conduit drums, nevertheless.

(Discussion off the record.)

Q. How long since you have had any new conduit, for the purpose of growth—to take care of growth?

A. Probably several years. Of course conduit may be required for purposes other than growth—when we are requested to go underground, or when it is desirable to go underground for our own reasons.

Q. When do you go underground. Why do you do that?

A. When the number of circuits carried along a route exceeds a certain amount, it is economical to concentrate those circuits in large underground cables having twelve hundred or eighteen hundred pairs in one sheath, and as a general proposition, it is not desirable to have very large cables on poles. They do not suspend very well. Another reason for going underground is objection of the public to aerial construction in certain locations.

Q. Have you been ordered to put your cable underground in any town in Nebraska, that you can recall?

A. Right now we are putting some cable underground [fol. 238] going west from Omaha in connection with the Dodge Street project.

Q. Ordered to do that by the city of Omaha?

A. I think we were urgently requested.

Q. I got the impression from your answer that it was customary for the ordinary town to order the company to put their lines underground.

A. I didn't mean it was customary for them to do it ordinarily, but it is something that happens frequently enough so we have to consider it.

Q. In other words, it has happened?

A. Yes, sir.

Q. In putting this underground conduit in place, it is customary to provide additional ducts for new cable that may be required?

A. Yes, sir. The amount of extra duct provided depends on what is the most economical arrangement. If you have requirement for one duct, it is customary to put in a multiple duct that naturally has a surplus capacity, because most main runs are made up of a duct which is customarily made in two or more ducts.

Q. In other words, you are looking forward, and you judge the future by the past, and you say that if one duct

is required now, considering expense, it might be advisable to put in a three duct conduit?

A. Two or four, probably, yes.

Q. Now, this underground conduit is expensive, is it not?

A. Yes, sir.

Q. You have provided well for the future in all your underground conduits, at least at the time it is placed?

A. Yes, sir, but some of that conduit is quite old right [fol. 239] now—was placed many years ago and is pretty well filled right now.

Q. Looking forward, would you say that you would have to place much new conduit in the next five years?

A. No, I don't think we would expect to place much new conduit in the next five years. One reason for that is that for some purposes, it is now practical to use an underground cable without conduit.

Q. Putting it in the ground with a certain treatment of the cable?

A. Protection and treatment of the cable.

Q. Would you say that the time is coming when the underground conduit will not be used?

A. No. There are underground conduits that are in locations where we have a concentration of cables, such as twelve or fifteen cables, and conduits will probably always be used in those locations, and where you already have conduit, it is cheaper to use it than it would be to bury a cable without conduit, but the extension of conduit for single cables will be reduced in the future because of this buried cable.

Q. How did you handle the paving, when you take a conduit out, have you figured that?

A. We don't remove conduit.

Q. Just leave it there?

A. Yes. If we abandon the conduit run, we plug it and fill the manhole with sand, and pave over it.

Q. And leave the conduit in the ground?

A. Yes, sir.

Q. At this point I would like to ask you if the company cables large business blocks—public buildings—for telephones?

[fol. 240] A. Yes, sir. That class of cable is known as house cable and there is a great deal of it in the larger cities.

Q. That cable the company pays for?

A. Generally speaking, yes, sir.

Q. And you have that cable in your plant account?

A. Yes, sir. I think it is included under exchange underground subsidiary cable.

Q. Isn't it a fact that in cabling business blocks and public buildings, the cable is practically permanent? You figure one installation will serve the life of the building?

A. I would not think so. Very often the original cabling is inadequate and has to be added to, which means that the average life of the entire installation will be reduced, and frequently it has to be moved and rearranged as the buildings are rearranged and offices changed. My impression is there is quite a little movement in that type of cable.

Q. You would know the size of the building before you planned your cable, wouldn't you?

A. We would know the initial size of the building.

Q. And you would know the approximate number of offices in the building?

A. Yes, but that is not a constant thing. That may change. The occupancy of buildings changes quite frequently in cities such as Omaha.

Q. How about such buildings as the Burlington depot—the new depot—and the Union Pacific?

A. I imagine that the amount of house cable in those structures is not very large for telephone purposes, and [fol. 241] of course it is quite new—those buildings both being relatively new. What the prospect for rearrangements and additions of cable in those buildings would be, I don't know.

Q. You are quite certain about your rates, are you not?

A. Yes, sir.

Q. Quite well satisfied with them?

A. Yes, sir.

Q. You have made a comprehensive study?

A. Yes, sir.

Q. And you worked it out very carefully to find these rates?

A. Yes, sir.

Q. And you expect those rates to be realized?

A. Yes, sir. We check them periodically. We have been checking them every year in detail for the last seven or eight years to my knowledge.

Q. Then if the Commission should apply one of these rates to aerial or exchange cable, knowing the number of years the cable has been in service, it would be possible to find the condition percent?

A. It would have nothing to do with the physical condition percent. You would find the amount that had been accrued in the reserve for that cable, but that wouldn't indicate anything as to whether that individual cable was in good condition or full of cracks or anything else.

Q. You are accruing the depreciation against——

A. We are accruing depreciation reserve at that rate, yes, sir. But the physical condition of the cable does not run parallel to that. The cable might be in 100% condition [fol. 242] and still have to come out because of the change of a street or something of that kind.

Q. Doesn't that point to the conclusion that your rates need changing?

A. No, sir. This depreciation rate here is merely the annual accrual necessary to provide a sum in the reserve equal to the cost of the plant when the plant is retired, regardless of the cause of retirement. The physical condition percent is not affected by many of the causes which do bring about retirement of cable, or by other classes of property. There are two different things, for whatever purpose you may want to use them. If you want to find the physical condition of a piece of plant, I know of no way to find it out expect to inspect it, and that inspection may give a result entirely different from the result you would get from a check of the depreciation reserve accrued. The same way that an insurance company might inspect a group of risks today and find them all 100%, but they would know that that would not mean that each one of those individuals would live to the maximum age that an individual can live to. There are factors that don't show up at all in the physical inspection, which must be recognized in accruing a reserve to protect the investment.

Q. The only conclusions I can come to is one of two things. Either the rate is wrong or the inspection didn't amount to much?

A. No, I think the answers are two different things. One is a factor determined by statistics, which is used in accruing a reserve to protect the investment. The other is an inspection to find out how much a given item of plant

[fol. 243] has been affected to date by wear and tear, obsolescence, inadequacy and other things. Many of those things operate suddenly, and until they do operate, there is no indication of them in the plant.

Q. Wouldn't an experienced inspector have in the back of his mind, or shouldn't he have—all of these causes and factors of depreciation you speak of?

A. Have all the causes and recognize them insofar as they have operated up to this time. But the fact that we are going to lose a few of these poles a year in storms, doesn't affect the present condition of the plant. The plant is all right until the storm hits it, but nevertheless we must accrue to protect ourselves from the loss that we know will come from storms. We don't know where it will be, but it will be some place.

Q. If you were the inspector looking at a piece of twenty-five pair cable in place, and knew that the cable was, you knew it was twenty-two years old, it wouldn't affect your judgment as to its condition?

A. To this extent: It would make it necessary to view that cable very carefully to see if there were any defects that wouldn't be apparent to a casual inspection, but if the defects were not there, I do not see how you could claim that the cable was more worn out than a careful inspection would indicate.

Q. You have enjoyed quoting life insurance statistics to me this morning and yesterday. Doesn't the life insurance man tell you quite definitely how long you are going to live?

A. They have average expectancies, yes, sir, but the average expectancy is not what you get from an inspection of the plant.

Q. And looking forward, there are mortality tables which [fol. 244] predict quite definitely when this class of indidivual is going to pass out?

A. They have an average expectancy for people of all ages.

Q. Now, you wouldn't consider it fair to use that in inspecting cable plant?

A. Not if you are trying to get the physical condition of the plant, because physical condition and the expectancy are two different things.

Q. I want to get your idea on that. If you were looking at a piece of cable in plant, you knew it was twenty-two

years old, and you knew that it was going to be taken out within thirty days, would you still say that the physical condition was a controlling factor?

A. The physical condition the controlling factor for what purpose?

Q. Purpose of depreciation.

A. Well, physical condition would not be the controlling factor in determining the service life, unless the cable were worn out.

Q. Very well, it is your duty to inspect this cable, and you inspect it and in your mind you find that the physical condition is say 90% and before you are through with the calculation, you are informed the cable is to be removed. Would you change your figures?

A. That would depend on the purpose of the conclusions, I would say.

Q. You are trying to find the fair amount of depreciation.

A. Well, the cable might be—if it were 90% condition, that would be a measure of the physical condition. The reserve requirement for that cable would be pretty close [fol. 245] to 100%, if the cable was going out in thirty days.

Q. And you would report the cable 90%?

A. That is what I found in the field. The use of that figure is another proposition.

Q. You didn't use it then, the physical condition of the property, with other factors, depreciation or any factor in depreciation except wear and tear or disintegration?

A. Yes, sir. If the cable were of a type that was obsolete from a standpoint of transmission, or other obsolescent features, that would be recognized.

Q. Well, I am not assuming obsolescence. I am saying it is operating efficiently.

A. Well, as far as that piece of cable is concerned, I would say its physical condition would be 90%, if that is what the inspection showed, if it were free from obsolescence and other factors, and giving good service.

Q. And yet, according to your table, in making a set up for the depreciation, you would provide for full reserve, a reserve equal to the original cost of the cable?

A. Yes, sir. Another factor there is that there may have been one, two or three cables in which we invested our money, and which are already gone, without giving us a

chance to accrue the full life on them, and if we didn't allow for that, we will be unable to protect the full investment. We expect that some cables will go well beyond expectancy, and we know we will lose many before they reach the expectancy.

Q. As I get the idea, your tables they are sure and certain, but they don't apply anywhere?

[fol. 246] A. They apply to the accrual of the depreciation reserve, on a basis which will accrue as closely as possible the cost of the plant during the time it is in service. The word depreciation probably is not the right word to use.

Q. They don't apply to any particular piece of property?

A. No, sir, they are averages.

Q. And yet it is necessary to have it actually in a reserve on the rate you have proposed here, in order to retire it at the end of its life?

A. Yes, sir.

By Commissioner Bollen:

Q. When you speak of percent condition of your properties for the purpose of determining the fair value, what do you mean?

A. Purpose of determining fair value. (As I understand the definition of the term, the percent condition of the property is the condition determined by inspection making allowance for all physical deterioration and all other factors tending to decrease the value insofar as they have operated up to the present time. It does not presume or assume the redesign of the plant and the substitution of something in place of it. For example, if we have a perfectly good fifty pair cable which for some good reason is to be displaced in a short time by a hundred pair cable, obviously you couldn't consider the fifty pair cable as having no value unless you were willing to put in place of it the value of the hundred pair cable that you would have there when the fifty pair wasn't there. As I interpret it, you inspect the property as you find it today, give allowance to all factors affecting the value now.)

[fol. 247] Q. When you speak of factors, you refer to visible factors rather than invisible factors?

A. Visible factors, and factors of which there is some evidence at the present time. For instance, cable might be of a type that is inadequate from a transmission stand-

point. That wouldn't be visible to the naked eye, but would be known by an engineer that was familiar with the design of the cable.

Q. Then as I take it, in determining the fair value of the property, there are factors that you don't consider at all, that is, factors you do use in building up your depreciation?

A. Yes, sir, there are things that bring about the retirement of cable, or any kind of plant, which are not discernible or cannot be determined from inspection.

Q. But would you not use the same factors in determining the fair value as you have used in building up your reserve?

A. I see no way in which existing plant could be penalized, for example, because of the average losses by fire and storm. It hasn't been affected as yet. We know it is going to be, and we set up a reserve against it. We don't know where it is going to come.

Q. Certain classes of property may never have it?

A. Not any particular piece, but on an average, we are going to have so much per year.

Q. You use that as a factor in building up your reserve over your state wide exchanges?

A. Yes, sir.

By Mr. Forbes:

[fol. 248] Q. Please be referred to Sheet 9 showing the service life and salvage value and annual depreciation rate for aerial wire, and explain the tabulation in your own way.

A. The aerial wire account consists of two main divisions, Exchange and toll. The exchange aerial wire is practically all iron wire, and the large majority of it is in rural districts. This wire has no value when it is retired, and there is a substantial cost of removal, so that the salvage is a negative figure. The service life of this wire is based on a turn over cycle study, and we have used twenty years as the average which we expect from the present plant. The physical life of iron wire varies considerably in different parts of the territory. In some places it doesn't rust very rapidly, and in other places it rusts out quite quickly. As a practical matter, when rust begins to attack the joints of a telephone circuit, it is very necessary to re-

place them. The same sort of rusting in a telegraph circuit would be much less serious.

The average service life of twenty years is substantially more than we get from these open wire lines at the edge of towns, because cables are continually being extended out and replacing these wires, so this service life is governed almost entirely by what may be expected on rural lines where the replacement by the extension of cable is very slight.

The toll wire is nearly all copper wire. Copper wire ordinarily has a high salvage value. The salvage value used in this depreciation rate is based on historical cost study such as we used in connection with cable accounts, and it indicates a salvage of 28%. If we had used current salvages, the salvage probably would have been in the [fol. 249] order of 5% or less, due to the low price prevailing for junk at the present time. The service life of the copper wire is based on a turn-over cycle study, and is taken at twenty-five years. Copper wire, in most places, will last indefinitely from a standpoint of wear and tear. However, the toll cable developments have progressed to a point where the heavy loads of open wire will be gradually replaced by cables. We have already had replacement of open wire by cables entirely across the State of Iowa. It is probable that within not more than ten years, and perhaps less, the main lines across Nebraska will be in cable instead of open wire. In the same way entrances into cities are made through cable instead of open wire, and these toll entrance cables are continually being extended further from town. And as those cables replace the leads where they have the most wires, the displacement of wire per mile is much higher than it would be for a length of cable out in the open country.

The iron wire in the toll plant is replaced sooner when it begins to rust than exchange iron wire, because installation charges are higher on toll, and the cost of removing iron wire from toll pole lines is generally more than the cost of removing iron wire from exchange lines, because these wires are nearly always on pole lines with other working circuits, and have to be handled with much greater care. There are also more poles per mile to detach the wire from. For those reasons, the cost of removal of toll iron wire is somewhat higher than for exchange iron wire, and the net

salvage is therefore a lot lower. The composite rate of 3.6% is developed by applying the rates determined for [fol. 250] the various kinds of wire, to the investment as of January 1, this year, but in our accounting so far, the rates have been applied to toll and exchange separately, and this composite has not been used.

One of the factors, particularly in Nebraska, in the life of wire, is the loss from storms. When a line is wrecked in a sleet storm, the wire is frequently replaced rather than attempting to patch up the old wire. That is just a brief outline of the consideration I gave to the wire accounts.

Q. The growth you spoke of in cable plant is responsible, to some extent, for the retirement of iron wire?

A. It was in the past a large factor, and this rate here we have practically eliminated that as most of our iron wire investment is now in the country.

Q. In the past years, it was not at all uncommon to find subscribers served on an open wire?

A. Yes, sir, that is true.

Q. And it was common practice to bring rural lines into the switchboard with open wire?

A. Yes, sir.

Q. Now since the use of cables has become so common, it is considered good practice to cable all of the town portions of the exchanges?

A. Yes, sir.

Q. And that resulted in the elimination of iron wire?

A. Yes, sir.

Q. Does your study cover that period of change from iron wire to cable?

[fol. 251] A. Most of this study came after the wholesale removal of heavy iron wire leads and replacement of them with cable. The Northwestern Company eliminated most of its town open wire services quite a few years ago.

Q. Has there been any improvement in the quality of iron wire for transmission purposes, and for life?

A. There have been some improvements, I believe, in galvanizing processes, and there have been some improvements in the wire from the standpoint of physical strength. The improvement, from the standpoint of transmission, is sort of an open question right now. There are some alloyed wires, I believe, such as copper weld, and so on, and I think the amount of advantage and use of those wires from

a transmission standpoint is something of an open question. There are stronger wires having good transmission properties than there were ten or fifteen years ago. However, in rural plant, where most of our wire is that sort, strength is more important than the conductivity.

Q. Does your study include modern galvanized wire?

A. Most of the wire in our plant now is standard galvanized wire. Most of it is fairly old right now. The amount of new wire placed in plant is not yet large enough to be a dominant figure. I imagine that ten years from now we will have a great deal more modern type of iron wire in our rural property than we have now.

Q. Did you consider that the wire in the plant now had become obsolescent?

A. I don't think that would be much of a factor in the rural lines. I think rust, and being replaced on that account, and I think in the rearrangement of rural lines, we [fol. 252] will put up new wire instead of trying to salvage any of the old wire.

Q. When you buy an exchange, or build an exchange, you don't plan for more than ten stations on a circuit in the country?

A. I think that is looked upon as the best practice.

Q. Then this rearrangement wouldn't necessarily affect your plant so much?

A. I had in mind rerouting of lines, moving them across the road and changing their location, either in connection with highway programs, which now seem to be headed toward the secondary roads, on which most of the rural plant is located.

Q. Is it your idea that the present highway program is to continue indefinitely?

A. I think that highway—the indications are that highway improvements will be extended to secondary roads to a greater extent, possibly, than they have in the past.

Q. And you plan that if you move a pole line, it is necessary to remove the wire?

A. Not necessarily, but when pole lines are moved, it may very well be more economical to string new wire than to try to handle the old wire, unless it is practically new, which generally will not be the case. In fact this average service life of twenty years is probably pretty close to the average physical life that you can get with satisfactory

service from the type of wire that comprises the bulk of our rural line today.

Q. You don't figure that there is going to be any improvement in quality from now on?

A. There are better wires available now, but we have very little of them in the plant. As they go in the plant, [fol. 253] any effect that results on service life and salvage will be reflected as the new wire goes in.

By Commissioner Bollen:

Q. Is there any difference in service life of wire between Nebraska and North Dakota and Minnesota?

A. In colder drier climates, rust usually progresses a little slower, and there is much less breakage of wire from sleet storms and wind in Minnesota and North Dakota than there is in Iowa and Nebraska.

Q. Then you think, if anything, there would be a longer service life in those two states than in Nebraska?

A. The poles have a longer service life.

Q. I am speaking of wire.

A. No. As a matter of fact, as far as the Northwestern Company is concerned, the large bulk of our investment in rural wire is in Nebraska and Iowa. We own much less rural plant in the northern states.

Q. Your property in this state extends all over northern Nebraska, north of the Platte River, and southwest Nebraska west of Hastings, does it not?

A. Yes, sir.

Q. Would there be any difference in that territory and southeastern Nebraska, as to the service life of wire?

A. Northeastern Nebraska is what we call heavy sleet area. Northwestern Nebraska, where we have relatively little plant, is, I think, drier and less subject to sleet storms. I don't know so much about southeastern Nebraska, because we don't have reports from that territory.

[fol. 254] Q. From what you said about North Dakota and Minnesota having a longer service life, wouldn't it follow that northeastern Nebraska would have a longer service life than southeastern Nebraska?

A. Not necessarily, because these zones of sleet storms are not entirely measured from north and south. For instance, up around Sioux Falls, there is a very bad sleet area. The topography of the country and the rivers and

so on are probably a big factor. The reason we have a distinct difference in some of these territories where there is a difference, is that there is a zone, all of southern Minnesota and Northern South Dakota, in which the Northwestern owns no plant. It isn't a shading off, it is a jump. There is a break there a hundred miles wide in which we have virtually no plant. Southern Minnesota is a fairly severe sleet area. Northern Minnesota is not.

Q. You think that is true as to northeast Nebraska and eastern South Dakota?

A. Yes, sir. Around Sioux Falls there have always been heavy losses in sleet storms.

Q. Then you think there might be a little difference in the service life in the Lincoln Telephone & Telegraph Company's territory in southeast Nebraska—that is, a longer service life in the southeast of Nebraska from your territory?

A. Northeast Nebraska might be better or worse than southeast Nebraska. I don't know enough about the history in southeastern Nebraska. We get reports from all the territories of all the sleet storms we experience.

Q. I notice the Lincoln company has a service life of twenty-two years in southeastern Nebraska territory, and [fol. 255] you have a service life of twenty-five, that is for toll?

A. We have twenty for exchange.

Q. And you have a service life of twenty-five years for toll—copper. They have t[illegible]rs combined. Why should there be that difference, if you know, between you and the Lincoln company?

A. I don't have enough knowledge of their operating conditions and property to have any opinion.

Q. Well, if there was a difference of say 3%, why should that 3% occur?

A. There might be a variety of reasons.

Q. You wouldn't want to say?

A. I would have to know more about the facts.

Q. You wouldn't want to say that either you had guessed wrong, or Mr. Wheeler had guessed wrong?

A. I wouldn't have any opinion on their figures unless I knew more about them.

Q. If it was practically the same territory and there was a difference of 3%, you would say somebody had gone wrong?

A. Not necessarily, no, sir. For intance, we might have a transcontinental toll line, for instance, subject to transmission requirements, that would be far in excess of shorter lines.

Q. We will assume that conditions are exactly the same, and you had a difference of five years.

A. If conditions were exactly the same, I expect the answer would be exactly the same.

Q. And if your service life is not the same, somebody has gone wrong?

A. Or conditions are different. If the conditions are the same in all respects, the answer should be the same, obviously.

[fol. 256] Q. You might have different data for your computations, however?

A. Different methods.

Q. But the facts are they should be the same if the conditions are exactly the same?

A. If conditions are exactly the same.

Q. I notice also on your exchange you have a minus 12% net salvage. They have 6.5% positive. Can you explain how they can sell their junk at a higher value than you can?

A. To the best of my knowledge, junk iron wire has no value as junk, no appreciable value.

Q. Well, you have a net salvage value of 28% for your toll copper. They have 34.1%. Might be a difference in the amount of copper in the two plants?

A. Might be a difference in the average cost of the copper in that plant with respect to the copper in service. Might be a difference in the average gauge of the wire. If you have a large gauge wire, the cost of installation is less in per cent of total cost.

Q. That might be better salesmanship here in Lincoln too, might it not, in disposing of their junk?

A. It is possible, although I have no reason to believe that that is a fact. As a matter of fact, I don't think either of us could get 5% salvage right now.

Q. How do you usually handle that salvage—by bids with some junk men?

A. Yes. We sell it by the carload.

Q. You don't attempt to work any of it back in the plant?

A. Very seldom, because it gets kinked in coiling it up.

[fol. 257] By Mr. Forbes:

Q. Please be referred to Sheet 10, Mr. Granfield, which shows the underground conduit, and explain the rates for depreciation.

A. Conduit is long lived item of plant. Nearly all of it is vitrified clay conduit of some type, sometimes completely encased in concrete, and sometimes partly encased. We have never had any conduit that wore out. Occasionally it settles or cracks or something, but it can be repaired. We have divided the conduit into two divisions, main conduit and subsidiary conduit.

The subsidiary conduits are short runs, frequently one duct, from a main run to a terminal pole or a building or some other outlet. There is no history of conduit covering a long enough period to permit the calculation of the service life. We have made an analysis of the retirements of subsidiary conduit on a turnover cycle basis, and that indicated the service life of around twenty-eight or twenty-nine years. So, for subsidiary conduit we have used thirty years.

Main conduit we have estimated the service life of sixty years, twice as long as subsidiary. We have in the conduit accounts, as well as the conduit itself, manholes which represent substantial investments. These manholes have been displaced from time to time, changing location or rebuilding them to provide space for loading coils. Conduit is retired, or has been in our experience, in connection with grading of streets and rerouting of streets, sometimes abandonment of a street. In Omaha, the grading of some of the streets in the last eight or ten years has resulted in fairly substantial retirements of conduit. The increasing use of load coils of cables have made it necessary to pro-
[fol. 258] vide much more space in manholes for the large tanks containing the load coils, and that has resulted in displacing many existing manholes and replacing them with much larger ones.

The salvage was taken at zero, although we know that there will be a slight negative salvage, because a conduit is never taken out of the ground, and there is some expense in connection with filling the manholes and plugging the duct when the conduit is abandoned, but that cost would be so small in comparison with the long life of the plant, and

the investment in the plant, we have called it zero for the purpose of depreciation rates, and used the estimated service life of sixty years for main and thirty years for subsidiary in setting up rates for depreciation.

Those figures represent our best judgment as to what we may expect to obtain from our present investment in underground conduit.

Q. Growth is the biggest factor in depreciation of conduit, is it not?

A. No. Growth might require adding conduit, but it wouldn't affect the life of it so very much. We might add to it, but we wouldn't take it out. I think the biggest factor would be changes in population centers. When we move a central office from one part of town to another, there are some heavy runs of conduit going to the old office that are retired from service. Not retired because we need more, but because we need them in a different place.

Changes in grades of streets is quite a factor. When they lowered the grade on St. Mary's Avenue in Omaha, there were quite a few blocks of heavy conduit run that had to be removed.

Q. Do you know of any other towns in Nebraska where grades in the streets have been changed so that it is neces- [fol. 259] sary to remove conduit?

A. No, I do not, off-hand, and I don't think that the investment in conduit in Nebraska, outside of Omaha, is very large. I think by far the biggest investmenf in conduit we have in the state of Nebraska, is at Omaha. It would be my guess that it would be more than all the rest combined, but I haven't checked that.

Q. As a matter of fact, this class of property is practically limited to the larger towns?

A. Yes, sir.

Q. When underground conduit is placed, you attempt to anticipate the future for some time, do you?

A. Yes, sir, particularly if it is placed in anticipation of paving, we plan to get sufficient conduit in so as to make it unnecessary to incur the expense of cut-ing the pavement later on. When a street is considered for pavement, a study is made and it is frequently found advisable to place conduit under that street before they pave it.

Q. Knowing what you know now, would you say that replacements of conduit by reason of growth and change of plant is as likely as it has been?

A. I don't think growth has much effect on the service life. I think we'll place less conduit in the future, for sometime in the future, than we have in the past, but that will not effect the present conduit because we don't tear that up anyway, merely add to it or put another run in beside it.

Q. Do you think there would be as much likelihood of moving your central office from one location to another, and have to rearrange your outside plant?

A. In the life of a conduit, I see no reason for expecting [fol. 260] anything much different than we have in the past. We estimate a life of sixty years. In that period we may have depressions and we may have booms. I don't think the experience of two or three years would amount to much in connection with an estimate of sixty years over-all life.

Q. You based your figures, however, on past experience?

A. Only in a very general way. We haven't enough past experience to calculate an answer from. On the subsidiary cable, we have had a considerable turn over and probably will continue to have on that, but the main cable, the bulk of the investment, is so much less than sixty years of age, that it is practically an estimate as to what will take place in the period of its life.

Q. Merely an estimate, then, and not based on any pretense——

A. No calculation at all. We have no calculation to cover enough history.

Q. Your judgment——

A. Judgment, yes, sir.

By Commissioner Bollen:

Q. I wish to state to you, Mr. Granfield, that you and Mr. Wheeler have arrived at exactly the same composite rate of 2% for underground conduit.

A. When you have long lived plant, it takes quite a difference in the estimate to make much difference in the rate.

Q. Your figures are different, but you both reach exactly the same rate.

By Mr. Forbes:

Q. Referring to Sheet 11 of your Exhibit 1, please ex-
[fol. 261] plain your depreciation rates and salvage values on furniture and office equipment.

A. Furniture and office equipment account takes the place of what was known as office furniture and fixtures in the old accounting system, and is substantially the same account, but not exactly. It consists of office machines, typewriters, adding machines, desks, chairs and other office furniture, and the average service life is determined by a turn-over cycle study of the investment. That study indicated that the average service life in the order of twelve or thirteen years has been experienced, and that the salvage resulting from the disposal of the retired furniture and equipment ran around eight to ten percent. So this rate was set up on an average service life of thirteen years, and the salvage at 10%.

Some of the equipment in this account, such as typewriters, are handled on a contract basis, the typewriters used for a definite period, three years I believe, then returned to the manufacturer with a definite salvage, and those facts are all reflected in this thirteen year service life and 10% salvage.

Q. You might explain that turn-over cycle period for the record. I don't believe it is fully described.

A. Well, briefly, the turn-over cycle method of determining the average service life consists in accumulating backwards, in reverse chronological order, the retirements from the account until the sum of these accumulated retirements is equal to the total investment. That is, if we accumulate retirements backward from 1930 and find that when we have accumulated on requirements back to 1920, the total amount of those accumulations equals the invest-
[fol. 262] ment in 1920, that would be a turn-over period of ten years. That briefly, is the procedure followed in determining turn-over cycle periods.

Q. Does that take into consideration, changes in price levels?

A. If turn-over cycle studies are made on a dollar basis, they are adjusted by the use of index numbers to eliminate the effect of price changes. If a turn-over cycle study is made of units such as crossarms, the price level of course

is not a factor. We also consider the effect of growth, and a mathematical calculation is made to adjust for any error due to growth during the period covered by the turn-over cycle.

Q. This classification doesn't include any property that is used in the transmission or inter-communication?

A. No, sir, it is all office equipment.

Q. It includes toll office equipment as well as exchange?

A. Yes, sir.

Q. When furniture needs repairs, does your company repair its own furniture?

A. In the larger offices we do.

Q. And then what do you do with the expense?

A. That, I believe, is charged to current expense, repair expense, classified as an expense against this account, but it doesn't enter depreciation.

Q. It does not?

A. No.

By Commissioner Bollen: Go ahead with the next one.

[fol. 263] By Mr. Forbes:

Q. Please explain your Sheet 12, with reference to service life, etc.

A. This account, vehicles and other work equipment consists of, as represented, by motor vehicles of various kinds, garage and shop equipment, special tools and other tools, which includes the ordinary tools of construction.

The motor vehicle portion of the investment is subdivided into three classes. Passenger cars and Ford trucks are one class, light trucks are another class, and heavy construction trucks in a third class.

The passenger cars and Ford trucks are numerous enough so that we can determine the average service life by means of mortality studies. The others are not as numerous, and we rely, to a large extent, on judgment.

Service life of passenger cars and Ford trucks is four years, with the salvage of 10%. Of course, when thinking of that four year service life, it must be remembered that a car in telephone service accumulates a good many miles per year. Light trucks, principally Ford trucks I believe —no, not Ford, but trucks other than Fords, have a slightly longer life than the Ford trucks and passenger cars.

The heavy construction trucks, such as White trucks and Mack trucks, have an average service life of nine years, with a salvage of 10%.

The garage and motor vehicle shop equipment is a very small account, only $15,000 and some odd hundred dollars in the whole territory. That is miscellaneous tools located [fol. 264] in company garages throughout the territory, and we estimated the service life at ten years, with no salvage.

Special tools and work equipment includes power tools of various kinds. I believe the hole boring machines are included, and they are subjected to very severe usage, and five year life is all we can expect from them, with a small salvage at the end of their life. The other tools and work equipment have a service life of four years, and a salvage of 40%. That account includes the shovels, pike poles and other ordinary construction tools. When they are not in use, they are returned to the Western Electric Company for repairs and reconditioning, if necessary, and then they are reissued for further use. That is the reason the salvage is as high as 40%. The short life and the high salvage results from the practice of turning the tools into the Western Electric for overhauling as they need it.

The composite rate for the entire account is 17.8%, but the rates have been currently applied, at least up to the present, to the component accounts, and not used in the composite form. All of these accounts are known as general accounts. They are not in our plant investment. They are officially tools and equipment used in the operation of the business.

Q. By that you mean to say that there is no reserve set up against this property?

A. Yes, sir, there is a reserve, but I believe the procedure is somewhat different. I am not certain just what the present accounting practice with respect to charging depreciation and accruing reserve for general equipment is. I think probably Mr. Baird could tell that more accurately than I.

[fol. 265] Q. Then you refer to a service life of four years for passenger cars and Ford trucks. Do you have any agreement with anybody, or any concern, to take over the old cars and furnish new ones?

A. I think that that is handled separately in each locality. I think in Omaha, for example, they deal with one institu-

tion and Minneapolis another, and so on. The salvage which we get from these vehicles, I think varies from year to year, but I believe there is some averaging out of the salvage on these cars when they are turned back. I think the cars are generally turned back to a dealer, and not sold individually.

Q. Do you repair your own cars in Omaha?

A. Well, whether we are now or not, I don't know. We have at times, and at other times did only part of it. To what extent we are repairing them now, I don't know. In any event, whether we do it ourselves or have it done by a garage man, the expense is not entered in depreciation.

Q. I note you have shop equipment?

A. We have some shop equipment, such as grinding wheels and small shop machines, and we do some repair work, but whether or not we do all of it, I don't know.

Q. What is the procedure when one of your local managers needs a new car?

A. We have motor vehicle supervisors in each area, and the handling of the motor vehicle transactions is supervised by him. Just what the procedures are, I don't know. The principal factor in this depreciation rate for motor vehicles is the life and salvage of the Ford trucks and Ford cars with special bodies, which comprise by far the biggest [fol. 266] part of the investment. The individual cars used for passenger cars are not a large factor in the answer, and just how they are handled, I don't know.

Q. Do you buy any of this equipment under contract?

A. I don't know that either. I presume there is some sort of an agreement, because we usually buy quite a few cars in a year. What the purchasing arrangements are, I don't know.

At this point in the hearing a ten minute recess was taken, after which the taking of testimony was resumed as follows:

By Mr. Forbes:

Q. Before arriving at the various annual rates of depreciation of the different classes of property, as detailed in your testimony, in finding the composite rate, did you take into consideration the credit to the depreciation reserve?

A. No, sir. We set out to find the average service life and average net salvage that we expected would result

from the plant we now have in service, without any regard to revenue or present state of reserve or anything of the kind. We were after those facts as to service life and salvage.

Q. You didn't make any study of your reserve to see whether it was growing or declining, in arriving at your salvage?

A. The reserve, as it is set up, is the reserve for the entire property, and it would show nothing by accounts, without a special analysis. Such an analysis is required by the Interstate Commerce Commission subsequent to their review of these rates, as I understand it, and we are pre- [fol. 267] paring to make a study to determine what the proper reserve requirements for the various classes of plant should be for the Northwestern Company at this time, and in making that study, we will pay no attention to what the credit reserve is. We try to find out what the reserve requirements are in accordance with the method developed to compute that. It is a very long calculation.

Q. If the history of the reserve shows that its been increasing from year to year for a number of years, and it now reaches a point where it is approximately 25% of your fixed investment, and has reached that point by the use of depreciation rates such as you presented here, would you still say that your figures were right?

A. Yes, sir. I would say that except within very wide limits, the size of depreciation reserve for a going telephone company gives you very little indication as to whether your depreciation rates are right or wrong. You have to go through a very long period of years, until an entire property has been run through the process, to be able to make studies based on the depreciation reserve which would give indications of true depreciation rates. For example, if you have a large investment and expensive and relatively new buildings or equipment that have not been in service long enough to have any of them retired, you will know that your reserve will be increasing steadily, from that factor alone, until it begins to be offset by the retirement of those large investments, which is a long time in the future.

Q. Now, the only investment of that kind you have, I take it, that would not turn over in the cycle of the life of

ordinary telephone property, is buildings, and that is in the amount of Fourteen Million Dollars?

[fol. 268] A. Buildings, conduit, and at the present time we have a very large investment in dial central office equipment, all of which is new, and the retirements against which have been very small to date. We have a very large investment in toll terminal equipment, the bulk of which is quite new, and retirements against which are very small as yet, so at the present time, if there wasn't a tendency for some increase in the accruals over the retirements, I would say it would be proof that the rates are too low, because it would show we are not getting any accrual in anticipation of the retirement of these very large investments, which haven't been represented at all in retirements as yet.

Q. However you have accumulated against those large investments, an amount in the reserve represented by your various percentages?

A. Yes, sir.

Q. Does it affect your judgment, or would it, to know that the company had used higher rates in the past than you now propose?

A. I know this company used higher rates in the past, and those rates applied to a different property than we now have. That is, a great deal of the property to which those rates applied has been retired and replaced by property taking low rates, with the result that the trend in the overall rate has been down, which has been as it should be. As you mentioned in connection with the rate on exchange aerial wire. Prior to 1912 or 1915, the exchange aerial wire rate probably should have been perhaps twice what it should be now, because they had heavy open wire leads on the main streets of towns, all of which were superseded by cable. After relatively short life, that plant came into the picture and passed out of the picture. If it were prop-

[fol. 269] erly provided for in the depreciation, it must have taken a fairly substantial rate, perhaps twice what the present rate is, to reimburse the company for that plant for the time it was in service.

Q. With the exception of two or three classes of property, such as buildings and underground conduit and main cable, which you have indicated here, of long life, why

wouldn't the annual depreciation expense be a reasonable guide to the rate?

A. Because your annual retirements do not bear any uniform relation to the investment. That relationship will depend on the relative age of the various parts of the investment, and will be periodically very largely increased by retirements of large and expensive items, such as buildings, which are not reflected at all in most years. Then there will be one year when they will come in with a very pronounced effect. When a company is in a situation that this company is in now, and most companies are now, that a large part of its investment is relatively new, the retirements will be much less than the accruals should be.

Q. Well, if you knew that the engineering department of your company had found all of the fixed investment and exchange property in this state to be in 89% condition within the last year, would you say that these reserves were still necessary?

A. Certainly.

Q. A large volume of that property turns over within fifteen or twenty years?

A. A fairly large volume, yes, sir. They increase the low period to get the turn-over as indicated by the gradual increase in service life. The turn-over period for our entire telephone property is also lengthened, which would [fol. 270] man that your annual retirements by themselves would not measure into it. We have so many other factors you have to weight in there before your annual retirements can give an indication.

Q. You computed these rates with the thought that your company was going to continue in the telephone business, or that the property was going to continue?

A. Yes, sir.

Q. You didn't compute these rates with the idea that the property was going to be wiped out of existence?

A. Not as of any one time, no, sir.

Q. And you thought, or at least it is so far as you know, that your company is going to continue?

A. Yes, sir.

Q. In the telephone business?

A. Yes, sir.

Q. If you knew that the depreciation reserve of this company was approximately one million seven hundred and

fifty thousand dollars in 1921, and is now approximately twenty-five million dollars, would you say that the rates that were used were proper?

A. Might be, I see no reason to question them on that account.

Q. That wouldnt' disturb you?

A. No, sir. There are too many other factors, that mean nothing to me so far as rates are concerned.

Q. And if the rates you testified to should exceed the requirements of the company for a long period of time, that wouldn't affect your judgment?

A. Not if by requirements you mean the actual or annual retirements. The annual retirements do not measure the [fol. 271] requirements. That is why I wouldn't consider them as a measure of requirements.

Q. Then it is all because you have three or four classes of property with a longer life than the average?

A. No, sir, because it is affected by the age distribution, by the property in each class of plant, and by the relative expectancy of the various classes of plant. Both of those are factors.

Q. But you are not accumulating this reserve with the thought that your company is going to salvage all its plant?

A. Not as of any one time, but ultimately everything we have in service is coming out. When it comes out, if our accounting is correct, we should have accrued the amount of the plant retired as shown on the books, less salvage, and no more.

Q. Your plant is old enough now so that it has reached what you might call an average operating condition, is it not?

A. It depends on what you mean by that. The telephone business is not static. Things change so rapidly that a telephone company never gets into a fixed gait and stays with it. There is always something that comes into the picture and upsets the whole scheme of things.

Q. Much of your property has turned over and over in your plant?

A. Some of it has.

Q. And it is still turning over, so that you have old property and new property. Wouldn't there be such a thing as a normal or average operating condition of the plant?

A. Only if you had an average age for each class of plant

equal to around half the average service life, and it would almost never happen that you would have enough coincidences to bring that about.

[fol. 272] Q. It's good engineering to get the full wearing value out of property, is it not?

A. Yes, sir, when it can be done economically.

Q. It is good engineering to continue plant in place as long as it serves?

A. As long as it gives good service safely, yes, sir.

Q. So that so far as you can see now, there isn't any demand for sudden replacement of a large amount of plant?

A. No, sir, and no such replacement was contemplated in developing these rates. In fact replacement rates lower than we have experienced in the past were anticipated in the development of all these rates.

Q. These rates you propose to submit to the officers of the company? You make your report of these rates to the company?

A. Yes, sir.

Q. You don't know what rates are applied?

A. These rates are applied.

Witness excused.

By Mr. Forbes:

Q. Mr. Baird, what rates do you use in making your set-up for depreciation reserve?

A. We use rates that have been developed by Mr. Granfield, as he explained, and come to us after being approved by our executive officers.

Q. Is it customary to change those rates from time to time?

A. All of the rates that we get are rates made up by Mr. Granfield in his organization. Any changes would be [fol. 273] changes that he works into the rates that he recommends. We ourselves do not make any changes after the rates come to us from him.

Q. I wanted to ask that for the reason that I notice from year to year, in times past, there have been changes in the composite rates.

A. The composite rate might change, of course, with the different amounts of property.

Q. Of the different classes?

A. Of the different classes. The rates are applied by classes of property. And incidentally, Mr. Forbes, in reports to the Commission up to January 1, 1933, we showed a composite of the depreciation to average plant in service subsequent to January 1, 1933. That percentage was applied to the average of depreciable property only, which made a slight change in the composite rate. It may be that change you are referring to.

Witness excused.

Mr. John H. Schnell, being first duly sworn to tell the truth, the whole truth, and nothing but the truth, testified as follows:

By Mr. Forbes:

Q. What is your occupation, Mr. Schnell?

A. Accountant for the Nebraska State Railway Commission.

Q. How long have you been the accountant for the Nebraska Commission?

A. Since June 1, 1929.

Q. How long have you been employed by the Commission?

A. Well, that is the date I have been employed by them in the accounting department.

[fol. 274] Q. What is your work now with the Commission?

A. Well, I work in the telephone department of the Commission. Part of the duties is taking care of and checking all the annual reports and other reports that are filed by the various telephone companies with this Commission.

Q. Does the report of the Northwestern Bell Company come to your office?

A. Yes, sir.

Q. Have you made a calculation showing the reserves for depreciable property and intangible capital, and the actual ratio of those reserves as shown by the reports of the company for the year 1932?

A. Yes, sir, I have.

Q. Handing you Exhibit 3, I will ask you if that was prepared by you?

A. Yes, it was.

Q. Please explain what the first column of figures, under the caption, right-of-way, are?

A. The figures under the column designated as right-of-way, were taken from the annual reports of the Northwestern Bell Company, and represents the balance in that account as of the date specified.

Q. Taken from the annual reports?

A. Yes, sir.

Q. Explain the second column.

A. The second column represents reserve provided for the capital account, and is the balance in that account as taken from the annual reports under the dates designated.

Q. What do you understand here by intangible capital? [fol. 275] Is that the right-of-way? Is that the way the right-of-way appears in the report?

A. Well, as I understand the term of right-of-way as used here is under the terms provided by the Interstate Commerce Commission system of accounts.

Q. Does it include more than the right-of-way, so far as you know?

A. No, it does not.

Q. What is the ratio of the reserve to the investment in the third column?

A. Well, for the various years, it started out in the original set-up of the Northwestern Bell Telephone Company January 1, 1921, the ratio of reserve to the investment was 5.79%. On December 31, 1921, it was 8.15%. December 31, 1922, 9.95%.

Q. Does that increase through the years annually to December 31, 1932, and become 25.99%?

A. Yes, sir.

Q. What is the next column, Mr. Schnell?

A. The next column represents the rate upon which the reserves is set-up for each respective year. It is a figure, I take, which was computed by the company and appears in the annual reports on file here.

Q. What's the next column, reserve debits?

A. The next column represents the total amount of debit entries for each particular year. That is the total amount of debits charged to the reserve account.

Q. And the next column?

A. Those are the total credit charges made to the reserve account in each respective year.

[fol. 276] Q. Exhibit 3 consists of three pages. I will ask you to explain the second page.

A. Page 2 of this exhibit follows on the order of Page 1. In arriving at the plant and equipment as they appear in Column 1, there was deducted from the fixed investment, intangibles, land and right-of-way.

Q. What's column 2?

A. Column 2 represents the balance in the reserve as shown by the reports as of the dates shown.

Q. Reserve for accrued depreciation has been increased from twelve million plus in 1921 to thirty million seven hundred and seventy-four thousand in 1932?

A. Yes, sir.

Q. And the third column?

A. Represents the ratio of depreciation reserve to the fixed investment.

Q. And what is the next column, average annual rate of reserve?

A. The next column represents the rates upon which the depreciation charges were based during each respective year. That is a company figure. That appears in their annual report.

Q. The next to the last column, reserve debits?

A. That represents a total amount of the charges debited to the reserve account during each respective year.

Q. And credits?

A. That is the same way. It represents the total credit charges made to the account during each respective year.

Q. Please refer to Page 3 of this Exhibit 3, and explain the columns in the same way. First, fixed investment.

[fol. 277] A. Total fixed investment was arrived at by deducting the intangibles, land and right-of-way from the company's total fixed investment, and the depreciation reserve represents the balance in the reserve account at the times specified.

Q. The third column?

A. The third column represents the ratio of the balance in the depreciation reserve account to the fixed investment for the various years.

Q. What's the fourth column?

A. The fourth column represents the rate of depreciation used for setting up the reserve for each year.

Q. And the fifth column?

A. Represents the rate for amortization of the right-of-way.

Q. Is the amortization of the right-of-way included in the debit charges in the last column?

A. On this page, I believe it is.

Q. What is this last column?

A. That is a combination of the two reserves so provided for the plant and equipment and the right-of-way.

Q. That is the total charges to reserves?

A. Both reserves.

Q. For depreciation and amortization?

A. Yes, sir.

By Mr. Forbes: Exhibit No. 3 is offered.

Which exhibit was duly received in evidence, marked Exhibit No. 3, and is in words and figures as follows:

[fol. 278]

EXHIBIT 3

Right of Way and Reserve Provided Therefor, on Yearly Basis, as Indicated by the Annual Reports of the Northwestern Bell Telephone Company on File with This Commission

Date	Right of Way	Reserve for Intangible Capital	Ratio of Reserve to Investment	Average Annual Rate of Reserve	Reserve Debits	Entries Credits
Jan. 1, 1921	$325,009.54	$18,807.77	%5.79	%....	$.....	$.....
Dec. 31, 1921	328,137.86	26,729.46	8.15	2.55	383.06	8,304.75
Dec. 31, 1922	340,892.03	33,921.83	9.95	2.55	1,235.62	8,427.99
Dec. 31, 1923	344,095.36	42,013.55	12.21	2.55	623.39	8,715.11
Dec. 31, 1924	354,809.68	51,707.49	14.57	2.55	15.08	9,709.02
Dec. 31, 1925	355,404.24	58,269.99	16.39	2.55	2,470.99	9,033.49
Dec. 21, 1926	368,442.92	67,461.46	18.31	2.63	11,485.02	20,676.49
Dec. 31, 1927	380,824.87	78,285.89	20.56	3.01	477.06	11,301.49
Dec. 31, 1928	394,277.99	90,055.33	22.84	3.02	Cr. 51.68	11,717.76
Dec. 31, 1929	474,445.11	114,966.22	24.23	2.93	1,947.17	26,858.06
Dec. 31, 1930	516,515.82	125,182.09	24.24	2.84	4,107.79	14,323.66
Dec. 31, 1931	520,304.49	130,252.72	25.03	2.77	9,333.61	14,404.24
Dec. 31, 1932	534,507.50	138,893.98	25.99	2.60	5,161.71	13,802.97

Company rates, computed on the average investment in right of way service, during each year.

[fol. 279]

Plant and Equipment and Reserve Provided Therefor on Yearly Basis, as Indicated by the Annual Reports of the Northwestern Bell Telephone Company, on File with This Commission

Date	Plant and Equipment	Reserve for Accrued Depreciation	Ratio of Reserve to Investment	Average Annual Rate of Reserve	Reserve Debits	Entries Credits
Jan. 1, 1921	$70,284,135.22	$12,065,014.19	%17.17	%....	$.....	$.....
Dec. 31, 1921	74,118,690.38	14,222,661.93	19.19	5.11	1,656,816.10	3,814,463.84
Dec. 31, 1922	75,884,410.69	15,883,754.45	20.93	5.06	2,137,835.24	3,798,927.76
Dec. 31, 1923	78,348,568.42	18,487,100.90	23.60	5.20	1,461,779.15	4,065,125.60
Dec. 31, 1924	83,249,357.52	21,244,493.11	25.52	5.19	2,269,399.29	5,026,791.50
Dec. 31, 1925	85,499,159.99	23,129,346.76	27.05	5.20	2,486,719.90	4,371,573.55
Dec. 31, 1926	88,226,588.84	24,925,328.21	28.25	5.19	2,715,976.29	4,511,957.74
Dec. 31, 1927	95,753,568.28	26,553,569.77	27.73	5.11	3,915,796.07	5,544,037.63
Dec. 31, 1928	100,211,581.30	26,609,605.89	26.55	5.09	5,028,398.45	5,084,434.57
Dec. 31, 1929	111,880,273.58	28,331,071.27	25.32	4.97	4,833,785.71	6,555,251.09
Dec. 31, 1930	119,514,676.63	29,096,295.71	24.35	4.89	5,203,226.05	5,968,450.49
Dec. 31, 1931	123,610,927.53	29,176,457.30	23.60	4.91	5,901,020.68	5,981,182.27
Dec. 31, 1932	126,962,097.18	30,774,818.09	24.24	4.67	4,277,488.36	5,875,849.15

Company rates computed on the average investment in telephone plant and equipment (except right-of-way).

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[fols. 280 & 281]

Total Fixed Investment and Reserves Provided Therefor on Yearly Basis, as Indicated by the Annual Reports of the Northwestern Bell Telephone Company, on File with This Commission

Date	Total Fixed Investment	Reserves for Depreciation	Ratio of Dep'n Reserves to Fixed Investment %	Average for Dep'n of Plant & Equip. %(X)	Rate for Amor. or Right-of-Way %#	Debit Charges to Reserves for Depreciation
Jan. 1, 1921	$72,004,288.77	$12,083,821.96	16.78	....	....	$.....
Dec. 31, 1921	75,843,571.58	14,249,391.39	18.79	5.11	2.55	1,657,199.16
Dec. 31, 1922	77,603,875.78	15,917,676.28	20.51	5.06	2.55	2,139,070.86
Dec. 31, 1923	80,093,094.02	18,529,114.45	23.13	5.20	2.55	1,462,402.54
Dec. 31, 1924	85,044,100.95	21,296,200.60	25.04	5.19	2.55	2,269,414.37
Dec. 31, 1925	87,309,371.50	23,187,616.75	26.56	5.20	2.55	2,489,190.89
Dec. 31, 1926	90,055,265.08	24,992,789.67	27.75	5.19	2.63	2,727,461.31
Dec. 31, 1927	97,686,300.30	26,631,855.66	27.26	5.11	3.01	3,916,273.13
Dec. 31, 1928	102,579,142.31	26,699,661.22	25.96	5.09	3.02	5,028,346.77
Dec. 31, 1929	114,391,610.72	28,446,037.49	24.88	4.97	2.93	4,835,732.88
Dec. 31, 1930	122,156,292.90	29,221,477.80	23.92	4.89	2.84	5,207,333.84
Dec. 31, 1931	126,297,404.48	29,306,710.02	23.20	4.91	2.77	5,910,354.29
Dec. 31, 1932	129,668,448.67	30,913,712.07	23.84	4.67	2.60	4,282,650.07

(X) Company rates, computed on the average investment in telephone plant & equipment (except right-of-way).
Company rates, computed on the average investment in right-of-way service, during each year.

[fol. 282] By Mr. Peycke:

Q. I don't very clearly understand what makes up this column on Sheet 3 headed total fixed investment, as compared with similar column on Sheet 2 which is headed plant equipment. What is there in the one that isn't in the other?

A. On Page 3 is included right-of-way, which is not included in the plant and equipment shown on Page 2.

By Commissioner Drake:

Q. That's the only difference?

A. Yes, sir.

By Mr. Peycke:

Q. On Page 1 you have the right-of-way set up separate, don't you?

A. Yes.

Q. It don't seem to add together here, to give the same result. The first item, plant equipment is $70,284,135.22, right-of-way $325,009.54. The two of them together you have something over $72,000,000. I haven't checked the others, so it may be a typographical error on that one.

A. I have a correction to offer there. In this total fixed investment as shown on Page 3, which also included intangibles and land plus the right-of-way. Intangibles, lands, right-of-way and plant and equipment.

Q. In the second column on Page 3 you show simply a combination of the reserve for accrued depreciation plus this reserve for intangible capital which you show on Page 1?

A. That's right.

Witness excused.

[fol. 283] By Commissioner Bollen: Anything further, Mr. Forbes.

By Mr. Forbes: I believe not.

By Commissioner Bollen: This will conclude the hearing, except that the respondent will submit schedule 1 sheet 1 and schedule 1 sheet 2 showing the same items and figures for Nebraska segregated from the other entire investment. That will be furnished as far as it can be furnished. Otherwise, submitted on the record.

Submitted on the Record

[fol. 284] The following exhibits were offered by the Commission, subsequent to the hearing, and are in words and figures as follows:

[fols. 285 & 286].

EXHIBIT 4

Northwestern Bell Telephone Company

Estimated Valuation of Exchange Service Property in the State of Nebraska Based on Average 1932 Cost Levels

Summary

Class of Plant	Book Cost Dec. 31, 1932	Percent Relationship of Reproduction cost to Book Cost	Estimated Reproduction Cost	Estimated Condition Percent	Estimated Reproduction Cost Less Depreciation
Right-of-way	$13,047	270.15	$35,246	100	$35,246
Land	205,373	105.74	217,161	100	217,161
Buildings	1,987,705	81.35	1,616,988	91	1,471,459
Central Office Telephone Equip.—					
Dial	3,272,274	90.56	2,963,371	92	2,726,301
Manual	1,467,083	91.33	1,339,887	86	1,152,303
Other Equipt. of Central Offices	59,011	96.54	56,969	85	48,424
Station Apparatus	1,730,086	90.04	1,557,769	90	1,401,992
Station Installations	637,627	111.69	712,166	89	633,828
Interior Block Wires	47,584	48.56	23,107	85	19,641
Private Branch Exchanges	501,942	101.82	511,077	90	459,969
Booths and Special Fittings	80,993	100.41	81,325	90	73,192
Pole Lines	1,989,027	90.90	1,808,026	80	1,446,421
Aerial Cable	1,670,306	86.36	1,442,476	90	1,298,228
Aerial Wire	439,212	96.87	425.465	80	340,372
Drop Wires	522,422	96.90	506,227	85	430,293
Underground Conduit	1,004,098	143.45	1,440,379	95	1,368,360
Underground Cable	1,786,664	100.73	1,799,707	90	1,619.736
Interest During Construction	271,871		1,106,064		986,418
Total Plant	$17,686,325		$17,637,080	89—	$15,723,331

EXHIBIT 4

Northwestern Bell Telephone Company

Estimated Valuation of Exchange Service Property in the State of Nebraska Based on Average 1932 Cost Levels

Summary

Class of Plant	Book Cost Dec. 31, 1932	Percent Relationship of Reproduction cost to Book Cost	Estimated Reproduction Cost	Estimated Condition Percent	Estimated Reproduction Cost Less Depreciation
Furniture and Fixtures	159,528	95.00	151,522	80	121,242
Stable and Garage Equipment	140,889	85.00	119,756	60	71,854
Tools and Implements	69,162	85.00	58,788	75	44,091
Store Equipment	5,541	100.00	5,541	80	4,433
Total General Equipment	$375,120		$335,637		$241,620
Total Plant and General Equipment	$18,061,445		$17,972,717	88+	$15,964,951
Working Capital					442,505
Going Concern Value					1,797,272
Grand Total					$18,204,728

Exhibit #12 offered in evidence by the Northwestern Bell Telephone Company at hearing held in the offices of the Nebraska State Railway Commission, Lincoln, Nebraska, on Wednesday, April 12, 1933. In the Matter of Investigation on the Commission's Own Motion Directing the Northwestern Bell Telephone Company to show cause why Rural and Switching Rates should not be reduced. (Resolution No. 128)—Transcript Volume 1 at Page 187.

[fol. 287]

EXHIBIT 5

Population of Incorporated Places in Nebraska in Which Exchanges Are Operated by the Northwestern Bell Telephone Company, for the Years 1930, 1920, and 1910

	1930	1920	1910
Ainsworth	1378	1508	1045
Alda	x153	x....	x....
Allen	489	485	371
Alliance	6669	4591	3105
Ashton	435	397	404
Atkinson	1144	1300	810
Atlanta	207	258	250
Axtell	328	385	394
Belgrade	386	493	400
Bellevue	1017	695	596
Bennington	375	314	276
Big Springs	x595	x408	x....
Boelus	....	....	....
Bridgeport	1421	1235	541
Bristow	183	255	175
Broken Bow	2715	2567	2260
Brule	x329	x....	x....
Butte	569	593	550
Cairo	425	427	364
Cedar Rapids	743	766	576
Central City	2474	2410	2428
Chadron	4606	4412	2687
Clarkson	918	884	647
Cody	408	428	185
Crawford	1703	1646	1323
Creston	346	381	338
Crookston	x373	x....	x....
Culbertson	820	686	580
Cushing	x141	x....	x....
Dakota City	417	399	474
Danbury	321	293	268
Dannebrog	427	436	380
Decatur	683	657	782
Elba	286	276	302
Elkhorn	411	333	291
Elm Creek	708	600	620
Elwood	509	473	464
Emerson	891	864	838
Farnam	394	408	462
Farwell	x....	x....	x....
Fremont	11407	9592	8718
Fullerton	1680	1595	1638

[fol. 288]

Gordon	1958	1581	920
Gothenburg	2322	1754	1730
Grand Island	18041	13947	10326
Gretna	477	491	484
Harrison	480	401	186
Holdrege	3263	3108	3030
Homer	452	491	397
Howells	952	904	800
Humphrey	854	835	868

(For footnotes see page 199)

EXHIBIT 5—Cont.

	1930	1920	1910	
Kimball	1711	1620	454	
Laurel	864	830	514	
Lebanon	262	245	197	
Lexington	2962	2327	2059	
Litchfield	404	428	403	
Long Pine	937	1200	781	
Loomis	213	238	284	
Loup City	1446	1364	1128	
Lyons	985	1025	865	
McCook	6688	4303	3765	
Mason City	447	487	480	
Millard	321	300	260	
Minden	1716	1527	1559	
Norfolk	10717	'8634	6025	
North Platte	12061	10466	4793	
Oakland	1433	1356	1073	# Including
Ogallala	1631	1062	643	So. Omaha
Omaha	214006	191601	124096	150,355
O'Neill	2019	2107	2089	
Overton	600	515	574	
Oxford	1155	739	593	
Papillion	718	666	624	
Pender	1006	992	804	
Pilger	578	563	471	
Potter	x515	x486	x....	
Primrose	210	155	158	
Ralston	x809	x455	x....	
Randolph	1145	1338	1137	
Ravenna	1559	1703	1359	
Rockville	241	208	201	
Rushville	1006	955	633	

[fol. 289]

St. Libory	x....	x....	x....	
St. Paul	1621	1615	1336	
Schuyler	2588	2636	2152	
Sidney	3306	2852	1185	
Silver Creek	464	583	379	
South Sioux City	3927	2402	1196	
Spalding	839	878	637	
Spencer	653	728	671	
Springfield	419	413	463	
Stratton	663	509	367	
Stuart	763	739	467	
Tekamah	1804	1811	1524	
Trenton	865	592	497	
Valentine	1672	1596	1098	
Valley	1039	764	810	
Wakfield	1112	1114	861	
Waterbury	204	190	199	
Waterloo	432	431	402	
Waune	2381	2115	2140	

(For footnotes see page 199)

EXHIBIT 5—Cont.

	1930	1920	1910	
West Point	2225	2002	1776	
Whitney	x177	x....	x....	
Winside	483	488	450	# Including
Wood River	751	820	796	So. Omaha
Total for 94 places	373,944	330,786	231,711	257,970
Average for Each	3,978+	3,519	2,465+	—2,744+

(For footnotes see page 5)

[fol. 290]

Population of Cities in Nebraska, of 5,000 or Over, in Which Exchanges are Operated by the Northwestern Bell Telephone Company, for the Years 1930, 1920, and 1910

	1930	1920	1910	
Alliance	6,669	4,591	3,105	
Fremont	11,407	9,592	8,718	
Grand Island	18,041	13,947	10,326	
McCook	6,688	4,303	3,765	
Norfolk	10,717	8,634	6,025	
North Platte	12,061	10,466	4,793	# Including
Omaha	214,006	191,601	124,096	So. Omaha 150,355
Total for 7 cities	279,589	243,134	160,828	187,087
Average for Each	39,941+	34,733+	22,975+	26,726+

Population of Incorporated Places in Nebraska of Between 3,000 and 5,000. in Which Exchanges are Operated by the Northwestern Bell Telephone Company, for the Years 1930, 1920, and 1910

	1930	1920	1910
Chadron	4,606	4,412	2,687
Holdrege	3,263	3,108	3,030
Sidney	3,306	2,852	1,185
South Sioux City	3,927	2,402	1,196
Total for 4 Places	15,102	12,774	8,098
Average for Each	3,775+	3,193+	2,024+

Population of Incorporated Places in Nebraska of Less than 3,000, in Which Exchanges Are Operated by the Northwestern Bell Telephone Co., for the Years 1930, 1920 and 1910

	1930	1920	1910
Total for 83 Places	79,253	74,878	62,785
Average for Each	954+	902+	756+

[fols. 291 & 292]

Population for years 1920 and 1930 taken from Fifteenth Census of the United States, 1930, Page 684, Table 5, Issued by the U. S. Department of Commerce, Bureau of the Census.

Population for year 1910 taken from Thirteenth Census of the United States, 1910—Volume III, Page 39, Table 2, Issued by U. S. Department of Commerce, Bureau of the Census.

x—Places not considered in totals and average population on account of date not available for the 3 years involved.

#—So. Omaha annexed to Omaha City between 1910 and 1920.

[fols. 293 & 294] EXHIBIT 6

Northwestern Bell Telephone Company

Record of Subscribers Stations

At—	Business	City Residence	Rural	Total Company Owned	Service Stations	Total All Stations
Dec. 31, 1929	35908	67,698	9747	113,353	10622	123,975
Dec. 31, 1930	37207	69,237	9813	116,257	10584	126,841
Dec. 31, 1931	37039	67,199	8403	112,641	10251	122,892
Dec. 31, 1932	34500	59,569	5952	100,021	9779	109,800
Dec. 31, 1933	33209	55,652	5006	93,867	8691	102,558

Authority: Company's Annual Reports on file with this Commission.

[fol. 295] STIPULATION RE EXHIBIT 7

At hearing held on May 15th, 1934, on Motion for a New Trial, the following stipulation was agreed to:

"It having been orally stipulated and agreed upon the hearing of the motion of respondent for a rehearing herein that the Uniform System of Accounts for Telephone Companies, First Revised Issue, prescribed by the Interstate Commerce Commission, might be considered and treated as in evidence in these proceedings, and said stipulation not otherwise appearing of record herein,

"It is hereby stipulated and agreed that said Uniform System of Accounts may be treated as in evidence in these proceedings as fully as if this stipulation had been made and filed prior to the making of a final order herein.

"Nebraska State Railway Commission, (Signed) by C. A. Randall, Chairman. (Seal.)

Attest:

(Signed) J. F. Miller, Secretary.

"Northwestern Bell Telephone Company, (Signed) by F. E. Randall, (Signed) Tracy J. Peycke, Its Attorneys."

Which exhibit was duly received in evidence, marked as Exhibit No. 7, and is in words and figures as follows:

[fol. 296] EXHIBIT 7

Uniform System of Accounts for Telephone Companies

Prescribed by the Interstate Commerce Commission in Accordance with Section 20 of the Interstate Commerce Act

First Revised Issue

Interstate Commerce Commission

Washington, D. C.

1933

Order

At a Session of the Interstate Commerce Commission, Division 4, Held in Its Office in Washington, D. C., on the 12th Day of November, A. D. 1932

The subject of a Uniform System of Accounts to be prescribed for and kept by telephone companies being under consideration, the following order was entered:

It is ordered, That the Uniform System of Accounts for Telephone Companies with the text pertaining thereto, embodied in printed form to be hereafter known as First Revised Issue, a copy of which is now before this Commission, be, and the same is hereby, approved; that a copy thereof duly authenticated by the Secretary of the Commission be filed in its archives, and a second copy thereof, in like manner authenticated, in the office of the Bureau of Accounts; and that each of said copies so authenticated and filed shall be deemed an original record thereof.

It is further ordered, That the said Uniform System of Accounts for Telephone Companies with the text pertaining thereto, be, and the same is hereby, prescribed for the use of telephone companies having annual operating revenues exceeding $50,000, subject to the provisions of the interstate commerce act, in the keeping and recording of their accounts; that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all accounts in conformity there-

with; and that a copy of the said First Revised Issue be sent to each and every such carrier and to each and every receiver or operating trustee of any such carrier.

It is further ordered, That in order that the basis of comparison with previous years be not destroyed, any such carrier or any receiver or operating trustee of any such carrier may, during the twelve months from the time that the said First Revised Issue becomes effective, keep and maintain, in addition to the accounts hereby prescribed, such portion or portions of its present accounts as may be deemed desirable by any such carrier, or by any receiver or operating trustee thereof, for the purpose of such comparison; or, during the same period, may maintain such groupings of the primary accounts hereby prescribed as may be desired for that purpose.

It is further ordered, That any such carrier or any receiver or operating trustee of any such carrier, in addition to the accounts hereby prescribed, may unless otherwise ordered, keep any temporary or experimental accounts the purpose of which is to develop the efficiency of operation: Provided, however, That such temporary or experimental accounts shall not impair the integrity of any primary account hereby prescribed.

It is further ordered, That any such carrier or receiver or operating trustee of any such carrier, may subdivide the accounts hereby prescribed to the extent necessary to secure the information required in the prescribed reports to commissions having jurisdiction.

It is further ordered, That the dates on which the said First Revised Issue of the Uniform System of Accounts shall become effective, be, and are hereby, fixed for Class A Telephone Companies on January 1, 1933, and for Class B Telephone Companies on January 1, 1934, provided that Class B Telephone Companies are permitted to adopt this system of accounts on January 1, 1933.

By the commission, division 4.

George B. McGinty, Secretary. (Seal.)

Introductory Letter

Interstate Commerce Commission,

The Bureau of Accounts

Washington, D. C., November 12, 1932.

To Telephone Companies:

This Uniform System of Accounts for Telephone Companies will supersede the Uniform System of Accounts for Telephone Companies, First Issue; effective January 1, 1913.

Under the interstate commerce act, the observance of the rules and regulations stated in this system of accounts becomes obligatory upon persons having direct charge of the accounts of the companies concerned, and such persons will be held responsible for their proper application.

Paragraph 6 of the twentieth section of the interstate commerce act provides that—

> In case of failure or refusal on the part of any such carrier, receiver, or trustee to keep such accounts, records, and memoranda on the books and in the manner prescribed by the Commission, or to submit such accounts, records, and memoranda as are kept to the inspection of the Commission or any of its authorized agents or examiners, such carrier, receiver, or trustee shall forfeit to the United States the sum of five hundred dollars for each such offense and for each and every day of the continuance of such offense, such forfeitures to be recoverable in the same manner as other forfeitures provided for in this Act.

In formulating this system of accounts this bureau enlisted the cooperation of State commissions and of telephone companies. All suggestions and criticisms of these parties have been given most careful consideration. Many of the suggestions have been incorporated in these accounting rules.

Condensed classifications have been provided for operating revenues and operating expenses of companies having annual operating revenues exceeding $50,000 but not more than $100,000.

The provisions of the order under 14700, Depreciation Charges for Telephone Companies, have been appropriately included in this system of accounts.

The revised rules for telephone companies having average annual revenues not exceeding $50,000 will subsequently be given consideration.

This bureau will be glad to give consideration promptly to all questions arising with regard to the correct interpretation of this system of accounts which are presented to it by the officers in charge of accounts of telephone companies.

In case the carrier finds it is not in position to install upon the date specified all records necessary to comply with this system of accounts and furnishes a statement giving full facts as to its situation and the causes therefor, with a request to defer the complete installation of the accounts to a period within or at the close of the calendar year 1933, such a request to defer complete adoption of this Uniform System of Accounts will be given consideration by this Commission. The accounts contained herein as compared with those now effective are not materially so different as to prevent the returns to this Commission in the annual reports for the year 1933 being stated in accordance with these rules. Such returns will therefore be required to be in accordance with this system of accounts.

Alexander Wylie, Director.

Instructions

General

1. Classification of companies.—(A) As of the effective date of this system of accounts, for the purpose of accounting, telephone companies are divided into three classes as follows:

Class A.—Companies having average annual operating revenues exceeding $100,000.

Class B.—Companies having average annual operating revenues exceeding $50,000, but not more than $100,000.

Class C.—Companies having average annual operating revenues not exceeding $50,000.

(B) Class A companies shall keep all the accounts of this system of accounts, which are applicable to their affairs.

(C) Class B companies shall keep all the accounts of this system of accounts, which are applicable to their affairs, ex-

cept that their accounts for operating revenues and expenses may be kept under the accounts of the condensed classification shown on pages 61, 64, and 65.

(D) This system of accounts is not prescribed for Class C companies.

NOTE.—In order that frequent changes may be avoided, companies operating established telephone plants may adopt the scheme of accounts indicated by the average of their annual revenues for three years immediately preceding the effective date of this order. If at the close of any calendar year the average of the annual revenues for the three latest years is greater than the amount applicable to the class in which the company has been accounting, the higher scheme of accounts shall be adopted. New companies shall estimate the amount of their annual revenues and adopt the scheme of accounts appropriate for the amount of such estimated revenues.

2. Records.—(A) The company's records shall be kept with sufficient particularity to show fully the facts pertaining to all entries in these accounts. Where the full information is not recorded in the general books the entries therein shall be supported by other records in which the full details shall be shown and the general book entries shall contain sufficient reference to the detail records to permit ready identification. The detail records shall be filed in such manner as to be readily accessible for examination by representatives of this Commission.

(B) Attention is directed to the following extract from the twentieth section of the interstate commerce act:

"Any person who shall willfully make any false entry in the accounts of any book of accounts or in any record or memoranda kept by a carrier, or who shall willfully destroy, mutilate, alter, or by any other means or device falsify the record of any such account, record, or memoranda, or who shall willfully neglect or fail to make full, true, and correct entries in such accounts, records, or memoranda of all facts and transactions appertaining to the carrier's business, or shall keep any other accounts, records, or memoranda than those prescribed or approved by the Commission, shall be deemed guilty of a misdemeanor, and shall be subject, upon conviction in any court of the United States

of competent jurisdiction, to a fine of not less than one thousand dollars nor more than five thousand dollars or imprisonment for a term not less than one year nor more than three years, or both such fine and imprisonment: Provided, That the Commission may in its discretion issue orders specifying such operating, accounting, or financial papers, records, books, blanks, tickets, stubs, or documents of carriers which may, after a reasonable time, be destroyed, and prescribing the length of time such books, papers, or documents shall be preserved."

The Commission's order specifying records which may be destroyed is contained in its "Regulations to Govern the Destruction of Records."

(C) Accounts which are clearly summaries of other accounts or subaccounts provided for herein (for example, account 100, "Telephone plant," which summarizes the balances in the telephone plant accounts or account 154, "Funded debt," which summarizes the balances in the several funded-debt subaccounts) are not required to be kept in the company's books. All accounts kept shall conform in numbers and titles to those prescribed herein, except that:

(1) Companies may subdivide any of the accounts, provided such subdivisions do not impair the integrity of the accounts prescribed. The titles of all such subdivisions or subaccounts shall refer by number or title to the accounts of which they are subdivisions. When subaccounts are thus kept, it is not required that the main accounts of which they are subdivisions shall also be kept in the company's books.

(2) Clearing accounts, in addition to those prescribed herein, may be kept when necessary in making the proper distribution of items to the appropriate primary accounts.

(3) Temporary or experimental accounts may be kept in addition to the accounts prescribed herein, for the purpose of developing the efficiency of operations, etc., provided such accounts do not impair the integrity of any accounts prescribed herein.

(D) As of the effective date of this system of accounts, the several accounts prescribed herein shall be opened by

transferring thereto the balances carried in the accounts previously maintained by the company. The company is authorized to make such subdivisions, reclassifications, or consolidations of such balances as are necessary to meet the requirements of this system of accounts.

* * * * * * *

(J) "Depreciation," as applied to depreciable telephone plant, means the loss in service value (note instruction 3-Y) not restored by current maintenance, incurred in connection with the consumption or prospective retirement of telephone plant in the course of service from causes which are known to be in current operation, against which the company is not protected by insurance, and the effect of which can be forecast with a reasonable approach to accuracy.

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(L) "Group plan," as applied to depreciation accounting, means the plan under which depreciation charges are accrued upon the basis of the book cost of all property included in each depreciable account, using the average service life hereof properly weighted, and upon the retirement of any depreciable property its full service value is charged to the depreciation reserve whether or not the particular item has attained the average service life.

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(P) "Net salvage value" means the salvage value (note instruction 3-W) of the property retired after deducting the cost of removal.

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(W) "Salvage value" means the amount received for property retired, if sold, or if retained for reuse, the value at which the material recovered is chargeable to account 122, "Materials and supplies."

(X) "Service life" means the period between the time of installation (note instruction 3-CC) of telephone plant and its time of retirement.

(Y) "Service value" means the difference between the book cost and:

(1) The salvage value (note instruction 3-W) for station apparatus.

(2) The net salvage value (note instruction 3-P) for other telephone plant.

(Z) "Straight-line method," as applied to depreciation accounting, means the plan under which the service value of property is charged to operating expenses and to clearing accounts and credited to the depreciation reserve through equal annual charges as nearly as may be during its service life.

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(C) When the cost of improvements to leased telephone plant is included in the telephone plant accounts, charges for depreciation thereof shall be made on such basis as will amortize the service value of such improvements during the period of their expected use.

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25. Telephone plant retired.—(A) Depreciable telephone plant: For the purpose of avoiding undue refinement in accounting for the replacement of small items of property, the accounting for retirements and replacements of depreciable telephone plant, as grouped below, shall be as follows:

(1) Units of property.—This group includes major items of property, a list of which is shown in Appendix A. The book cost of any such item retired shall be credited to the plant account and charged to account 171, "Depreciation reserve," whether or not replaced. (See also par. (B) of the text of account 171.) The cost of property installed in place of the property retired shall be charged to the appropriate telephone plant account.

(2) Minor items.—This group includes any part or element which is not designated as a unit of property. The book cost of any minor item of property retired and not replaced shall be credited to the plant account and charged to account 171 (see also par. (B) of the text of that account), except that if the book cost of a minor item of property is accounted for through the retirement of units of

property, no separate credit to the telephone plant account is required when such an item is retired. Except as provided in note under account 231, "Station apparatus," in Appendix A, if minor items of property are retired and replaced (apart from the unit of property of which they form a part or with which they are associated) no adjustment shall be made in account 171. The cost of the replacement shall be charged to the account appropriate for the cost of repairs of the property, except that if the replacement effects a substantial betterment (the primary aim of which is to make the property affected more useful, of greater durability or of greater capacity) the excess cost of the replacement over the estimated cost at current prices of replacing without betterment the minor items retired shall be charged to the appropriate telephone plant account.

(B) Station installations, drop and block wires: When stations are removed from customers' premises the book cost of the station installations carried in account 232, "Station installations," and of any drop and block wires carried in account 233, "Drop and block wires," thereby retired from service shall be credited to the plant accounts and charged to account 607, "Station removals and changes." The latter account shall be credited with the salvage value (note instruction 3-W) of such property recovered. The cost of the removal of the station apparatus, inside, drop and block wires shall be charged to account 607.

(C) Land: The book cost of land retired shall be credited to account 211, "Land." If the land is sold, the difference between such book cost and the sale price (less commissions and other expenses of making the sale) of the land shall be credited to account 401, "Credits for telephone plant sold," or debited to account 410, "Debits for telephone plant sold," as may be appropriate. If the land is retained by the company and held other than for immediate sale, the book cost shall be charged to account 103, "Miscellaneous physical property." The accounting for leaseholds retired shall be as provided for in the texts of account 172, "Amortization reserve," and account 671, "Operating rents."

(D) Determination of book costs: The book cost of telephone plant retired shall be the amount at which such property is included in the telephone plant accounts when such

amount can be determined from the company's records. Ordinarily, such records shall be used in the retirement of land, buildings, complete central offices, furniture and other items of plant for which individual cost records are maintained. When the actual book cost can not be determined from the records, it shall be estimated. When it is impracticable to determine the book cost of each item due to the relatively large number or small cost of such items, the average book cost of all the items shall be used in determining the book cost of the items retired. The latter method may be applied in retirement of such items as telephones, bell boxes, station installations, poles, cross arms, wire, cable, cable terminals, conduit, and non-multiple private branch exchange switchboards.

(E) The accounting for the retirement of Organization, Franchises, Patent rights and Undistributed cost of property, shall be as provided in the texts of account 172, "Amortization reserve," account 413, "Miscellaneous debits to surplus," account 673, "Telephone franchise requirements," and account 675, "Other expenses."

(F) When telephone plant is sold together with the telephone traffic associated therewith, the book cost of the property shall be credited to the appropriate plant accounts and the estimated amounts carried with respect thereto in the depreciation and amortization reserve accounts shall be charged to such reserve accounts. The difference, if any, between (a) the net amount of such debit and credit items and (b) the consideration received (less commissions and other expenses of making the sale) for the property shall be included, if a debit, in account 410, "Debits for telephone plant sold," and if a credit, in account 401, "Credits for telephone plant sold." The accounting for depreciable telephone plant sold without the traffic associated therewith shall be in accordance with the accounting provided in paragraph (B) of account 171, "Depreciation reserve."

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Depreciation Accounting

80. Computation and filing of depreciation rates.—(A) The company shall file with the State commission or commissions having jurisdiction, for review and recommendations to this Commission, estimates of the composite annual

percentage rates considered applicable to the book cost of each class of depreciable telephone plant owned or used by the company. These percentage rates shall be based upon the estimated service values and service lives developed by a study of the company's history and experience and such engineering and other information as may be available with respect to prospective future conditions. These percentage rates shall be computed in conformity with the group plan of accounting for depreciation and shall be such that the loss in service value of the property, except for losses excluded under the definition of depreciation (note instruction 3-J), may be distributed under the straight-line method (note instruction 3-Z) during the service life of the property. Such percentage rates shall for each primary account comprised of more than one class of property produce a charge to operating expenses for that account equal to the sum of the amounts that would otherwise be chargeable for each of the various classes of property included in the account. The estimates of the composite annual percentage rates so filed shall be accompanied by a sworn statement showing the bases therefor and the methods employed in their computation. Where no State commission has jurisdiction or is willing to act in the premises, the estimates and the accompanying statement shall be filed with this Commission. A company subject to the provisions of this system of accounts January 1, 1933, shall file such estimates not later than August 1, 1933. A company which becomes subject to the provisions of this system of accounts after January 1, 1933, shall file such estimates within six months after the provisions of this system of accounts become applicable to it. After consideration of the recommendations of the State commission or commissions to the extent available, this Commission will by temporary order prescribe the composite annual percentage rates which shall be charged with respect to each class of depreciable telephone plant. After the issuance of the temporary order, opportunity will be afforded at public hearings, if desired, for the presentation of evidence by all interested parties with a view to the modification of such order and for the submission of views based on such evidence. Such public hearings shall be conducted for this Commission, so far as possible, by State commissions. The company shall be prepared

at any time upon direction of this Commission to compute and submit, for its approval, revised percentage rates in cases where existing rates are deemed inapplicable.

(B) In the event any composite percentage rate prescribed by this Commission, in the judgment of the company becomes no longer currently applicable, the company shall in a like manner file estimates of revised composite annual percentage rates which, in its judgment, should be established.

(C) The company shall keep such records of property and property retirements as will reflect the service life of property which has been retired, or will permit the determination of service-life indications by mortality, turnover, or other appropriate methods, and also such records as will reflect the percentage of salvage value, or net salvage value, as appropriate, for property retired from each class of depreciable telephone plant.

81. Depreciation charges.—(A) Charges for currently accruing depreciation shall be made monthly to account 608, "Depreciation," and account 702, "Vehicle and other work equipment expense," as appropriate, and corresponding credits shall be made to account 171, "Depreciation reserve." In computing the current monthly charges, one-twelfth of the composite annual percentage rate applicable to the primary accounts covering depreciable telephone plant shall be applied to the average of the balances, as of the first and last of the current month, in each such primary account.

(B) In addition, when the company is responsible under the terms of a lease for depreciation of property, used but not owned, for which the rent is chargeable to account 303, "Rent for lease of operating property," depreciation charges shall be made on the same basis as for owned depreciable property.

(C) A separate composite annual percentage rate for each account covering depreciable telephone plant shall be used in computing depreciation charges. Such composite rates shall be those which are from time to time prescribed by this Commission; except that where no rates previously have been prescribed for the company's use by this Commission, the company's estimates of composite annual per-

centage rates computed in accordance with instruction 80 shall be used prior to the date rates prescribed by this Commission become effective.

82. Classes of depreciable telephone plant.—The classes of depreciable telephone plant and the accounts covering such plant are as follows:

Right of way (account 207).
Buildings (account 212).
Central-office equipment (account 221).
Station apparatus (account 231).
Private branch exchanges (account 234).
Booths and special fittings (account 235).
Pole lines (account 241).
Cable (account 242).
Aerial wire (account 243).
Underground conduit (account 244).
Furniture and office equipment (account 261).
Vehicles and other work equipment (account 264).

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171. Depreciation reserve.—(A) This account shall be credited with amounts concurrently charged to account 608, "Depreciation," and account 702, "Vehicle and other work equipment expense," for currently accruing depreciation (note instruction 3-J) of telephone plant (see also instructions 80, 81, and 82). It shall also be credited with any amounts which the company may elect to charge to account 413, "Miscellaneous debits to surplus," and transfer to this account in respect of past accrued depreciation not provided for. (See also instructions 20-C and 21.)

(B) At the time of retirement of depreciable telephone plant, this account shall be charged with the book cost of the property retired plus the cost of removal (except the cost of removal of station apparatus) and shall be credited with the salvage value and insurance recovered, if any. It shall be credited with amounts chargeable to account 138, "Extraordinary maintenance suspense," as provided in instruction 83. (See also instruction 25.)

(C) For corporate ledger and balance sheet purposes this account shall be regarded and treated as a single composite reserve. However, for purposes of analysis, each

company shall maintain subsidiary records in which the depreciation reserve is broken down into component parts corresponding to the primary telephone plant accounts which include depreciable telephone plant (see also instruction 82); these subsidiary records shall show the current credits and debits to the reserve in complete detail by such primary plant accounts.

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608. Depreciation.—This account shall include the amount of depreciation charges applicable to the accounting period for all classes of depreciable telephone plant, except for plant classified in account 264, "Vehicles and other work equipment." The depreciation charges shall be made in accordance with instructions 23-C, 80, 81, and 82. (See accounts 315 and 174 for depreciation of miscellaneous physical property.)

[fol. 297] Reporter's certificate to foregoing transcript omitted in printing.

[fol. 298] Certificate to Bill of Exceptions

Office of the Nebraska State Railway Commission, Lincoln, Nebraska

We, the undersigned, C. A. Randall, Chairman of the Nebraska State Railway Commission, and Audrey W. Smith, official stenographer of the Nebraska State Railway Commission, do hereby certify that the within and foregoing is a full, true and complete transcript of all evidence offered and received upon the hearing of General Order No. 59, in the matter of depreciation charges for Class "A" and Class "B" Telephone Companies, Re: Northwestern Bell Telephone Company, before the Nebraska State Railway Commission, together with all motions, offers, objections, rulings, and orders of said Commission thereon, and all exceptions to such rulings and orders; that all of said evidence was recorded by the undersigned official stenographer of said Nebraska State Railway Commission and reduced to writing by them; and that on the application of Northwestern Bell Telephone Company, this bill of exceptions, was, on motion duly carried, allowed and settled by

the Nebraska State Railway Commission as the true bill of exceptions in the matter of said General Order No. 59, which together with the pleadings and filings, duly certified under the seal of the Nebraska State Railway Commission, constitute the complete record and the evidence upon which said case is presented to the Supreme Court of Nebraska.

Dated at Lincoln, Nebraska, this 3rd day of July, 1934.

(Signed) C. A. Randall, Chairman, (Signed) Audrey Smith, Official Stenographer. (Seal.)

[File endorsement omitted.]

[fol. 299] IN SUPREME COURT OF NEBRASKA

ORDER OF SUBMISSION—Jan. 21, 1935

The following causes were argued by counsel and submitted to the Court:

No. 29312. In re depreciation charges for telephone companies. Northwestern Bell Telephone Co. v. Nebraska State Railway Commission. Appeal Nebraska State Railway Commission.

Charles A. Goss, Chief Justice.

[fols. 300 & 301] IN SUPREME COURT OF NEBRASKA

No. 29312

In re Depreciation Charges for Telephone Companies

NORTHWESTERN BELL TELEPHONE CO., Appellant,

v.

NEBRASKA STATE RAILWAY COMMISSION, Appellee

Appeal from the Nebraska State Railway Commission

JUDGMENT—March 1, 1935

This cause coming on to be heard upon appeal from the Nebraska State Railway Commission, was argued by coun-

sel and submitted to the court; upon due consideration whereof, the court finds no error apparent in the record of the proceedings and judgment of said Railway Commission. It is, therefore, considered, ordered and adjudged that said judgment of the Nebraska State Railway Commission be, and hereby is, affirmed and that appellee recover of and from appellant its costs herein expended, taxed at $——; for all of which execution is hereby awarded, and that a mandate issue accordingly.

Charles A. Goss, Chief Justice.

[fol. 302] IN SUPREME COURT OF NEBRASKA

29312

In re Depreciation Charges NORTHWESTERN BELL TELEPHONE COMPANY

v.

NEBRASKA STATE RAILWAY COMMISSION

OPINION—Filed March 1, 1935

1. Appellant having had an opportunity to make a defense in the hearing before the state railway commission, upon which hearing a 1934 depreciation rate was fixed, the order fixing the rate is not void because appellant was not thus afforded due process of law under the state and federal Constitutions.

2. Until the interstate commerce commission fixes the rates of depreciation upon local class A telephone company property for intrastate purposes, the state railway commission has jurisdiction and authority to prescribe such rates.

3. Evidence and record examined and the final order of the state railway commission affirmed.

[fol. 303] Heard before Goss, C. J., Good, Eberly, Day, Paine and Carter, JJ., and Thomsen, District Judge.

Goss, C. J.

This is an appeal from Nebraska state railway commission.

The matter was initiated by an order made by the commission November 29, 1933, directing all class A telephone companies (those having average annual operating revenues exceeding $100,000) and class B telephone companies (those exceeding $50,000 and up to $100,000) to file with the commission, not later than March 1, 1934, a schedule of depreciation rates by primary accounts which they propose to apply for the year 1934, together with supporting data.

Appellant is a class A company. It seasonably filed its return, but the commission, being dissatisfied, ordered the cause set for hearing March 19, 1934, for "oral examination of the members of respondent's staff, who prepared said schedules, and for the introduction of such evidence as the commission may desire to submit with opportunity of objections and cross-examination by respondent." The record and bill of exceptions show that attorneys and witnesses of appellant appeared and a hearing was held, lasting two days, and the record thereof covering upwards of 200 pages. An inventory and cost engineer and the general auditor of appellant and an accountant for the commission were examined and various schedules, calculations and exhibits were introduced in evidence. At the conclusion of the oral hearing, the cause was "submitted on the rec- [fol. 304] ord," as appears both in the bill of exceptions and in the transcript of the pleadings, orders and filings.

On April 9, 1934, the record shows an opinion, finding and order. The commission reduced appellant's proposed rate of 4.48 per cent. and entered an order fixing a depreciation rate of 3½ per cent. upon depreciable property, including right of way, to be applied by the respondent for the year 1934.

Appellant presents four contentions:

First. That it was not given full notice of the scope of the hearing and full opportunity to make a defense in the 1934 depreciation rate; that therefore the order was void because it did not afford appellant due process of law under the state and federal Constitutions.

Second. That, since appellant is engaged in both interstate and intrastate commerce, and the congress has committed the matter of uniform accounting of common carriers of interstate commerce, including telephone companies, to the interstate commerce commission, the state

commission was without authority to act on matters of accounting even with respect to intrastate commerce.

Third. That the order is void because it is not based on evidence sufficient to support it, and is contrary to the evidence.

Fourth. That the commission erred in denying the motion of appellant to vacate the order and to grant a hearing and a new trial.

[fol. 305] The Constitution and laws of Nebraska "confer administrative and judicial powers upon the commission in addition to the main purpose of its creation, which is the exercise of legislative powers." Hopper Telephone Co. v. Nebraska Telephone Co., 96 Neb. 245. The matter is not here for trial de novo, but for judicial review as to the legality of the order of which appellant complains. The appeal and procedure are provided for by section 75-505, Comp. St. 1929.

As to the claim that appellant had no sufficient notice of the scope of the hearing, the record shows that it appeared and for two days participated in the hearings and furnished its schedules showing the rates of depreciation on various kinds of property owned and used by it. Some of these percentage rates were high and others low, depending upon the character of the property to which the schedules applied. From them the company arrived at a composite rate of depreciation of 4.48 per cent. The commission fixed a composite rate of 3½ per cent. We are not afforded much help by the evidence or by the printed and oral arguments, in determining just how either the appellants or the commission reached their respective conclusions on this point. But when the record shows that all the evidence was taken that either party desired to offer and that the cause was submitted on the record without objections of any sort until after the decision, we think we ought not, in such a case, to reverse the action on the ground that, after the judgment was entered against a party, it can then claim it was taken by surprise as to the [fol. 306] scope of the action. Indeed, even after the final order was entered, on the hearing of the motion for new trial, the parties stipulated (and it appears in the bill of exceptions) on May 15, 1934, for the admission of additional evidence. This was incorporated in the bill of ex-

ceptions in the form of a book of 101 pages on Uniform System of Accounts for Telephone Companies, issued by the interstate commerce commission in 1933. Until the motion for rehearing was filed, setting up the points now relied on, the record does not show that the commission as a court had any notice that appellant was aggrieved by the procedure. The evidence shows that counsel for the telephone company at the outset of the hearing suggested names of parties having to do with the calculation of the rate. Most of these were examined at length in a hearing apparently conducted with all the formality of any court. It appears all through the evidence that what the commission and telephone company were seeking was the proper evidence upon which to base a proper rate of depreciation to be used by the commission in 1934 only. If the telephone company had offered or proposed to offer other or further evidence and had been refused the opportunity, it would have presented a different question than that now before us. We think appellant had timely notice of the scope of the hearing, appeared generally, and was afforded due process of law in the matter.

"The due process provision of the Fourteenth Amendment has regard not to matters of form but to substance [fol. 307] of right." Western Indemnity Co. v. Rupp, 235 U. S. 261.

Paragraph 5, sec. 20, title 49, U. S. C. A.—the interstate commerce act—authorizes the interstate commerce commission, in its discretion, to prescribe the forms of all types of accounts to be kept by carriers and makes it unlawful for such carriers to keep any other forms of accounts than those prescribed by the commission. Appellant argues therefrom that it has no right to keep, or to be required by the state railway commission to keep, its accounts in the form prescribed by the state commission. We do not find that the interstate commerce commission has ever seen fit to act upon the question of the rate of depreciation to be used in intrastate compannies though they may do an interstate business. Even assuming that the congress has authorized such action (which we do not decide), and assuming that the ultimate decision would rest with the interstate commerce commission as to intrastate rates (which also we do not decide), and that the state railway commis-

sion would be bound by that decision, still, the federal commission not yet having acted upon the question, the state commission has the right to act until such time as the federal commission exercises its authority.

The supreme court, Chief Justice Hughes writing the opinion, said in Smith v. Illinois Bell. Tel. Co. (1930) 282 U. S. 133 (on p. 159): "The company urges that, as Congress has granted jurisdiction to the Interstate Commerce Commission over the depreciation rates of telephone companies doing an interstate business (Interstate Commerce [fol. 308] Act, sec. 20 (5), as amended by Transportation Act (February 28), 1920, U. S. C., title 49, sec. 20) this subject is now completely withdrawn from the power of the state. It is said that the two rates of depreciation cannot be charged on the same property. The Interstate Commerce Commission has had the matter under consideration (Telephone and Railway Depreciation Charges, 118 I. C. C. 328-333) but, so far as we are advised, a final determination has not yet been made. The Interstate Commerce Commission has its accounting rules with reference to depreciation charges and, pending its orders under section 20 (5) of the Interstate Commerce Act, telephone companies, as well as others subject to the act, have been directed to continue to observe these requirements. The company argues that, although the Interstate Commerce Commission has not finally ruled, the action taken by Congress excludes the jurisdiction of the state tribunals under familiar principles. (citing cases). We are unable to assent to this view. As the Interstate Commerce Commission has not acted finally in the matter, we are not now called upon to consider the scope of its authority in relation to depreciation charges, but we are of the opinion that, in any event, until action has been taken which could be deemed validly to affect the amount to be charged to depreciation in connection with intrastate business so as to affect intrastate rates, the prerogative of the state to prescribe such rates, and the jurisdiction and duty of the statutory court in considering their validity to determine the amount properly allowable for depreciation in connection with the intrastate business, are not to be [fol. 309] gainsaid. Compare Board of Railroad Commissioners v. Great Northern R. Co., 281 U. S. 412, 74 L. Ed. 936, 50 Sup. Ct. Rep. 391. Accordingly, the court should make appropriate findings with respect to the amount to

be allowed in this case as an annual charge for depreciation in connection with the intrastate business." This case appears to be decisive authority on the precise point involved here.

Appellant relies upon Interstate Commerce Commission v. Goodrich Transit Co. (1912) 224 U. S. 194. That relates to an order of the interstate commerce commission "prescribing the method of accounts and bookkeeping as to the operating expenses of the carriers" of freight and passengers—in this case a steamship company operating on the Great Lakes. The commerce court had enjoined the operation of the rates as applied to interstate business. The supreme court held the orders valid and reversed the cause. We think the case is not applicable here. If the interstate commerce commission had entered the field by prescribing depreciation rates for class A telephone companies to use in intrastate business, the principles of the cited case might be usable.

While we do not fully understand the logical processes by which appellant reached one rate and the appellee reached another rate of depreciation, yet, whether the rate here fixed is a legislative or judicial matter for the commission, it is, we think, a determination over which the commission had jurisdiction. It was for 1934 only and steps [fols. 310 & 310a] had already been taken to fix the rate for 1935. If the rate should prove to be confiscatory, if and when applied, it is quite likely the appellant will be able to discover a remedy. We think the evidence was sufficient to support the order. Finding no reversible error in the proceedings, the final order of the railway commission is affirmed.

[fol. 311] Petition for rehearing and brief in support thereof covering 24 pages, filed April 6, 1935, omitted from this print. It was denied, and nothing more by order of May 4, 1935.

[fol. 312] IN SUPREME COURT OF NEBRASKA

[Title omitted]

ORDER DENYING REHEARING—May 4, 1935

This cause coming on to be heard upon motion of appellant for a rehearing herein, was submitted to the court;

upon due consideration whereof, the court finds no probable error in the judgment of this court heretofore entered herein. It is, therefore, considered, ordered and adjudged that said motion for rehearing be, and hereby is, overruled, and a rehearing herein is denied.

Charles A. Goss, Chief Justice.

[fols. 313 & 314] IN SUPREME COURT OF NEBRASKA

[Title omitted]

ORDER STAYING MANDATE—May 6, 1935

On motion of appellant for an order to withhold issuance of mandate herein, pending appeal to the United States Supreme Court, it is by the court ordered that the issuance of mandate be withheld pending proceedings for review of this case in the Supreme Court of the United States.

Charles A. Goss, Chief Justice.

[fol. 315] IN SUPREME COURT OF NEBRASKA

General Number 29312

[Title omitted]

PETITION FOR APPEAL—Filed July 5, 1935

To the Chief Justice of the Supreme Court of the State of Nebraska:

Your petitioner, Northwestern Bell Telephone Company, the appellant above named, respectfully shows:

1. The appeal to the Supreme Court of the State of Nebraska in said cause was from an order of the Nebraska State Railway Commission, made and entered April 9, 1934, fixing a rate to be used by your petitioner in computing the expense of depreciation upon its property in the State of Nebraska for the year 1934. In making said order said Commission purported to act under the authority conferred upon it by the Constitution and statutes of the State of Ne-

braska. The review of said order by the Supreme Court of the State of Nebraska was had as prescribed by the statutes of the state, such court being the highest court of law and equity in said state in which a judicial review of said order and a decision of the matters in controversy could be had. Upon such appeal your petitioner set up and asserted the invalidity of said order, but the order appealed from was in all respects affirmed by the judgment and decision of said Supreme Court entered on the first day of March, 1935. Thereafter and within the time permitted by the rules of practice of said Supreme Court, your petitioner regularly moved said Court to vacate said decision and to grant a rehearing. Said motion was on the fourth day of May, 1935, in all things denied, and the judgment of said Court theretofore entered as aforesaid thereby became final.

[fols. 316 & 317] 2. There were errors in the final judgment and proceedings in this cause in the said Supreme Court of the State of Nebraska, whereby petitioner is aggrieved in that there was drawn in question in said cause in said Court the validity of a statute of the State of Nebraska, on the ground of its being repugnant to the Constitution and laws of the United States. The statute of the State of Nebraska, the validity of which was so drawn in question, was the said order of the Nebraska State Railway Commission, made and entered April 9, 1934. The decision and judgment of said Supreme Court was in favor of the validity of said order and statute of the State of Nebraska. The errors of which petitioner complains appear from the assignments of error presented and filed with this petition.

3. Petitioner further shows that for the reasons aforesaid this case is one in which under the legislation in force when the act of January 31, 1928 (45 Stat. L. 54) was passed, to-wit, under Section 237(a) of the Judicial Code (28 U. S. C. A. Sec. 344) a review could be had in the Supreme Court of the United States on writ of error.

Wherefore, petitioner prays for the allowance of an appeal from said final judgment of the Supreme Court of the State of Nebraska to the Supreme Court of the United States in order that said decision and judgment may be examined and reversed; and further prays that a transcript

of the record, proceedings and papers in this cause, duly authenticated by the Clerk of the Supreme Court of the State of Nebraska, may be sent to the Supreme Court of the United States in accordance with the rules of that Court.

Dated July 5, 1935.

F. E. Randall, Tracy J. Peycke, Attorneys for Petitioner.

[File endorsement omitted.]

[fol. 318] IN THE SUPREME COURT OF NEBRASKA

[Title omitted]

ASSIGNMENT OF ERRORS—Filed July 5, 1935

Comes now the appellant above named, Northwestern Bell Telephone Company, and assigns as errors, upon which it will rely upon its appeal to the Supreme Court of the United States from the judgment and decision heretofore entered herein in the said Supreme Court of the State of Nebraska, the following:

1. That the Supreme Court of the State of Nebraska erred in holding that the making of said order did not violate and abridge the rights of appellant under Section 1 of Article XIV of the amendments to the Constitution of the United States in that said order deprived appellant of property without due process of law because no notice was given to appellant that the said Commission contemplated making any order affecting appellant's depreciation rates for 1934, and no opportunity was given appellant to be heard as to the legality or propriety of the issuance of said order.

2. That the Supreme Court of the State of Nebraska erred in holding that said order of the Nebraska State Railway Commission is valid as against appellant's contention that inasmuch as appellant was at all times here material- engaged in interstate commerce and subject to the provisions of the Interstate Commerce Act (49 U. S. C. A. Sec. 1), exclusive authority to regulate its accounting had been vested by Congress, by virtue of said Act (Sec. 20,

Par. 5) and pursuant to the Commerce Clause of the Constitution of the United States (Art. I, Sec. 8, Par. 3), in the Interstate Commerce Commission, which authority had been fully exercised by the establishment of a Uniform System of Accounts for Telephone Companies applicable to appellant.

[fol. 319] 3. That the Supreme Court of the State of Nebraska erred in refusing to reverse and set aside the order of the Nebraska State Railway Commission made April 9, 1934, for the reason that said Commission had no power or jurisdiction to make said order in that said order is in conflict with regulations and orders of the Interstate Commerce Commission, then in force and effect, which had been made pursuant to Section 20, Paragraph 5 of the Interstate Commerce Act (49 U. S. C. A. Sec. 20(5)).

4. That the Supreme Court of the State of Nebraska erred in holding that, notwithstanding appellant employs its property in said State in interstate commerce and has been required by federal authority to use separate rates of depreciation for each of its several classes of depreciable property, the State of Nebraska has power by the order of said Commission to require appellant to use a single rate of depreciation of 3½% per annum upon all of its depreciable property in the State of Nebraska.

5. That the Supreme Court of the State of Nebraska erred in holding that the said order did not violate and abridge the rights of appellant under Section 1 of Article XIV of the amendments to the Constitution of the United States in that said order deprived appellant of its property without due process of law and denied to appellant the equal protection of the laws because said order deprived appellant of the right to maintain true and accurate accounts recording the expenses of its business.

6. That the Supreme Court of the State of Nebraska erred in holding that the said order did not violate and abridge the rights of appellant under Section 1 of Article XIV of the amendments to the Constitution of the United States in that it deprived appellant of property rights without due process of law because there was no substantial evidence to support a finding that the depreciation rate pre-

scribed was proper, or to furnish a lawful basis for an order requiring its use.

7. That the Supreme Court of the State of Nebraska erred in holding that the said order did not violate and abridge the rights of appellant under Section 1 of Article XIV of the amendments to the Constitution of the United States in that it deprived appellant of property without due process of law and denied to appellant the equal protection of the laws because the method adopted by the said Commission in ascertaining a rate of depreciation by fixing a [fols. 320-325] rate upon the controlling principle that it be sufficiently low to reduce the balance in appellant's depreciation reserve account, was unsound and contrary to law and was not calculated to produce the true amount of depreciation expense of appellant during the period to which the said order relates.

Wherefore, the appellant above named prays that the judgment of the Supreme Court of the State of Nebraska in the above entitled cause be reversed and that a judgment be rendered in favor of appellant for the relief prayed for upon its appeal to the Supreme Court of Nebraska, with costs.

F. E. Randall, Tracy J. Peycke, Attorneys for Appellant.

[File endorsement omitted.]

[fol. 326] IN SUPREME COURT OF NEBRASKA

[Title omitted]

ORDER ALLOWING APPEAL—Filed July 5, 1935

Upon the petition of the above named appellant, Northwestern Bell Telephone Company, for the allowance of an appeal to the Supreme Court of the United States from the judgment entered herein on March 1, 1935, assignment of errors and statement of the basis of jurisdiction of the Supreme Court of the United States being presented and filed therewith,

It is ordered, that said appeal be and the same is hereby allowed as prayed.

It is further ordered, that bond on appeal, to be approved by the undersigned, is fixed at the sum of Five Hundred Dollars ($500.00).

Dated this 5th day of July, 1935.

E. E. Good, Acting Chief Justice of the Supreme Court of the State of Nebraska.

[File endorsement omitted.]

[fols. 327-346] IN SUPREME COURT OF NEBRASKA

[Title omitted]

ORDER ALLOWING APPEAL—July 5, 1935

Upon the petition of the above named appellant, Northwestern Bell Telephone Company, for the allowance of an appeal to the Supreme Court of the United States from the judgment entered herein on March 1, 1935, assignment of errors and statement of the basis of jurisdiction of the Supreme Court of the United States being presented and filed therewith,

It is ordered that said appeal be and the same is hereby allowed as prayed.

It is further ordered that bond on appeal, to be approved by the undersigned, is fixed at the sum of Five Hundred Dollars ($500.00).

E. E. Good, Acting Chief Justice.

[fol. 347] IN SUPREME COURT OF NEBRASKA

[Title omitted]

PRÆCIPE FOR TRANSCRIPT OF RECORD—Filed July 9, 1935

To George H. Turner, Clerk of the Supreme Court of the State of Nebraska:

You will please prepare the Transcript of Record for Appeal in the above entitled cause to the Supreme Court of the United States, and incorporate in said Transcript the following documents, certified as required by law:

1. Præcipe upon Appeal from the Nebraska State Railway Commission to the Supreme Court of the State of Nebraska.

2. Transcript.
3. Bill of Exceptions.
4. Order of Submission to the Supreme Court of the State of Nebraska.
5. Judgment of the Supreme Court of the State of Nebraska.
6. Opinion of the Supreme Court of the State of Nebraska.
7. Motion for Rehearing.
8. Order of the Supreme Court of the State of Nebraska Denying Motion for Rehearing.
9. Order Withholding Mandate.
10. Petition for Appeal.
11. Assignment of Errors.
12. Statement Showing the Basis of Jurisdiction.
13. Order Allowing Appeal.
14. Copy of Appeal Bond and Order Approving Same.
15. Citation.

[fol. 348] 16. Notice to Appellee Directing Attention to Paragraph 3 of Rule 12 of the Rules of Practice of the United States Supreme Court.

17. This Præcipe for Transcript of Record.

18. Certificate of the Clerk of the Supreme Court of the State of Nebraska Showing that at the time of allowing the appeal and issuing the Citation the Honorable E. E. Good was the Acting Chief Justice of the Supreme Court of the State of Nebraska.

19. Proof of Service of the following documents on Appellee by Appellant:

(a) Petition for Appeal.
(b) Order Allowing Appeal.
(c) Assignment of Errors.
(d) Statement as to Jurisdiction.
(e) Statement Directing Appellee's Attention to Paragraph 3 of Rule 12 of the Rules of Practice of the United States Supreme Court.
(f) Citation.
(g) This Præcipe for Transcript of Record, together with Waiver of Right to Designate Additional Portions of the Record.

F. E. Randall, Tracy J. Peycke, Attorneys for Appellant.

Dated July 8, 1935.

On this 9th day of July, 1935, the undersigned attorneys for the Appellee above named, hereby acknowledge service of the foregoing præcipe, and state that the documents therein specified constitute all of the material parts of the Record necessary and proper to be included in the Transcript thereof upon appeal to the Supreme Court of the United States, and waive the right to designate any additional portions of the Record to be included in said transcript.

Wm. H. Wright, Atty. Gen'l of Nebraska, by Edwin Vail, Asst. Atty. Gen'l; Edwin Vail, Asst. Atty. Gen'l, Attorneys for Appellee.

[File endorsement omitted.]

[fol. 349] Clerk's certificate to Acting Chief Justice omitted in printing.

[fol. 350] Clerk's certificate as to bond omitted in printing.

[fol. 351] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 352] Clerk's return to order allowing appeal omitted in printing.

[fol. 353] SUPREME COURT OF THE UNITED STATES

STATEMENT OF POINTS RELIED UPON PURSUANT TO RULE 13 OF THE RULES OF THE SUPREME COURT, AND DESIGNATION OF PARTS OF RECORD TO BE PRINTED—Filed Aug. 7, 1935.

Appellant, Northwestern Bell Telephone Company, states that the points upon which it intends to rely upon its appeal herein are as follows:

I

Absence of Notice and Hearing

The order of the Nebraska State Railway Commission made April 9, 1934, here in question, is void under Section 1, Article XIV of the Amendments to the Constitution of the United States for the reason that said order was made without such notice and opportunity for hearing as is required by the due process clause of said Fourteenth Amendment. The Supreme Court of the State of Nebraska erred in upholding said order as against this objection of appellant. (Assignment of Error No. 1.)

II

Jurisdiction of State Commission

(A) The said order is void for the reason that, inasmuch as the accounting by appellant for the expense of depreciation was at all times here material controlled by regulations of the Interstate Commerce Commission pursuant to the Interstate Commerce Act (49 U. S. C. A. Sec. 20, Par. 5), and under the authority of the Commerce Clause of the Constitution of the United States (Art. I, Sec. 8, Par. 3), the Nebraska State Railway Commission was without power or jurisdiction to make said order prescribing a depreciation rate of 3½ per cent per annum upon appel- [fol. 354] lant's depreciable property in Nebraska. The Supreme Court of Nebraska erred in upholding said order as against this objection of appellant. (Assignment of Error No. 2.)

(B) The said order of April 9, 1934, is void for the reason that it was in conflict with regulations and orders of the Interstate Commerce Commission then in force and effect prescribing the rules, principles and methods pursuant to which appellant was required to account for the expense of depreciation. The Supreme Court of Nebraska erred in upholding said order as against this objection of appellant. (Assignments of Error, Nos. 3 and 4.)

III

Taking of Property Rights Without Due Process

The said order of April 9, 1934, is void for the reason that it deprives appellant of property rights without due process of law and denies to appellant the equal protection of the laws, contrary to the Fourteenth Amendment to the Constitution of the United States, in that

(A) It deprived appellant of the right to maintain true and accurate accounts recording the expenses of its business;

(B) It is not supported by any substantial evidence; and

(C) It purports to require the use for accounting by appellant of a rate of depreciation which was intended to be and in fact was less than the true rate, in order to reduce the balance in appellant's depreciation reserve account.

The Supreme Court of Nebraska erred in upholding said order as against his objection of appellant and in refusing to hold that the principles upon which the order was based were unsound and contrary to law and operated to deprive appellant of its property without due process of law. (Assignments of Error Nos. 5, 6 and 7.)

Appellant further states that it thinks that the whole of the record, as filed, with the exceptions hereinafter stated, is necessary for the consideration of the foregoing points, and that the same is necessary to be printed for the consideration of the court upon the present appeal. The papers not so necessary to be printed are:

[fol. 355] 1. Exhibit 7, Uniform System of Accounts for Telephone Companies, First Revised Issue, except the following portions thereof, which only should be printed:

a. Title page.
b. Order appearing at pages (V) and (VI.)
c. Introductory letter appearing at pages (VII) and (VIII).
d. Instruction 1, page 1.
e. Instruction 2, pages 1 and 2.
f. Instruction 3 (J) page 4, "Depreciation."
g. Instruction 3 (L) page 4, "Group plan."

h. Instruction 3 (P) page 4, "Net salvage value."
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j. Instruction 3 (X) page 5, "Service life."
k. Instruction 3 (Y) page 5, "Service value."
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m. Instruction 23 (C) page 15.
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o. Instruction 80, pages 20 and 21, Computation and filing of depreciation rates.
p. Instruction 81, pages 21 and 22, Depreciation charges.
q. Instruction 82, page 22, Classes of Depreciable Telephone Plant.
r. Instruction relating to Account No. 171, Depreciation reserve, page 36.
s. Instruction relating to Account No. 608, Depreciation, page 70.

2. Bond on this appeal.
3. Citation.

F. E. Randall, Tracy J. Peycke, Attorneys for Appellant.

The undersigned attorneys for the appellee herein, hereby acknowledge due and timely service of the above statement of points to be relied upon and designation of the parts of the record to be printed, and agree that the said [fol. 356] designation includes all parts of the record material and necessary to the consideration of the case, and hereby expressly waive all right to file a counter-designation of parts of the record to be printed.

Dated August 2, 1935.

Wm. H. Wright, Attorney-General, by Edwin Vail, Ass't Att'y Gen'l; Edwin Vail, Ass't Att'y Gen'l, Attorneys for Appellee.

[fol. 357] [File endorsement omitted.]

Endorsed on cover: File No. 39,904. Nebraska Supreme Court. Term No. 350. Northwestern Bell Telephone Company, Appellant, vs. Nebraska State Railway Commission. Filed August 7, 1935. Term No. 350, O. T., 1935.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935.

No. 350

NORTHWESTERN BELL TELEPHONE COMPANY,
Appellant,

vs.

NEBRASKA STATE RAILWAY COMMISSION.

APPEAL FROM THE SUPREME COURT OF THE STATE OF NEBRASKA.

STATEMENT AS TO JURISDICTION.

F. E. RANDALL,
TRACY J. PEYCKE,
Counsel for Appellant.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 350

NORTHWESTERN BELL TELEPHONE COMPANY,
Appellant,

vs.

NEBRASKA STATE RAILWAY COMMISSION.

STATEMENT AS TO JURISDICTION.

The appellant above named, in support of the jurisdiction of the Supreme Court of the United States to review the above entitled cause upon appeal, respectfully represents:

(a)

The statutory provision which sustains the jurisdiction of the Supreme Court of the United States is Section 237 of the Judicial Code as amended (28 U. S. C. Sec. 344(a)) and as further modified by the Act of January 31, 1928 (45 Stat. L. 54, 28 U. S. C. A. Sec. 861a, Sec. 861b).

(b)

The statute of the State of Nebraska, the validity of which is involved upon this appeal, is that certain order of the

Nebraska State Railway Commission, made and entered April 9, 1934, from which an appeal was taken to the Supreme Court of the State of Nebraska in the above entitled proceeding as provided by the statutes of Nebraska, and which order was affirmed by the final judgment of said Supreme Court, — Nebr. —, 259 N. W. 362, which judgment it is now sought to have reviewed by the Supreme Court of the United States. The text of said order has not been officially published. The said order after certain recitals as to a hearing which preceded its issuance was, as amended by a further order of May 15, 1934, in the following terms:

> "It is therefore ordered by the Nebraska State Railway Commission that the composite depreciation rate of the Northwestern Bell Telephone Company be and the same is hereby fixed at 3½ per cent upon all of its depreciable property in Nebraska, including right-of-way, for the year 1934.
>
> "It is further ordered that the Northwestern Bell Telephone Company be and is hereby directed to use a composite rate of 3½ per cent upon all of its depreciable property in Nebraska including right-of-way, for the year 1934 for purposes of accounting and reporting to the Nebraska State Railway Commission."

(c)

The date of the judgment of the Supreme Court of the State of Nebraska sought to be reviewed was March 1, 1935, and this judgment became final on May 4, 1935, by virtue of the denial on that date of a motion for a rehearing duly and seasonably made by appellant in accordance with the rules of the Supreme Court of the State of Nebraska. The application for appeal to the Supreme Court of the United States is presented to the Acting Chief Justice of the Supreme Court of the State of Nebraska on July 5, 1935.

(d)

1. The said order is a statute of the State of Nebraska within the meaning of Section 237 of the Judicial Code, 28 U. S. C. 344(a):

King Manufacturing Company v. *City Council of Augusta et al.*, 277 U. S. 100;

Sultan Railway and Timber Company v. *Department of Labor and Industries of the State of Washington et al.*, 277 U. S. 135.

2. The Nebraska State Railway Commission has been vested by the Constitution of the State of Nebraska (Art. IV, Sec. 20) with legislative, administrative and judicial powers. *Hooper Telephone Company* v. *Nebraska Telephone Company*, 96 Nebr. 245, 147 N. W. 674.

The order here in question is a statute of the State of Nebraska purporting to be made effective by virtue of the powers so conferred upon said Commission.

3. The judgment of the Supreme Court of the State of Nebraska became final within the meaning of Section 237 of the Judicial Code, 28 U. S. C. 344(a) upon the overruling of a seasonable motion for rehearing in said court:

Gypsy Oil Company v. *Escoe*, 275 U. S. 498.

4. The appeal to the Supreme Court of the State of Nebraska brought in question the validity of said order upon the ground that it was repugnant to Section 1 of Article XIV of the amendments to the Constitution of the United States, to Article I, Section 8, Paragraph 3 of the Constitution of the United States, to Article VI, Paragraph 2 of the Constitution of the United States, and to Section 20, Paragraph 5 of the Interstate Commerce Act (49 U. S. C. Sec. 20(5)) and to the order of the Interstate Commerce

Commission made pursuant thereto on November 12, 1932, prescribing a Uniform System of Accounts for Telephone Companies, and to the System of Accounts so prescribed. The decision of the Supreme Court of the State of Nebraska was in all things in favor of the validity of said order.

It is therefore submitted that the Supreme Court of the United States has jurisdiction of this appeal by virtue of Section 237 of the Judicial Code as amended, 28 U. S. C. Sec. 344(a), and as modified by the Act of January 31, 1928, 45 Stat. L. 54, 28 U. S. C. A. Sec. 861a, Sec. 861b.

F. E. RANDALL,
TRACY J. PEYCKE,
Attorneys for Appellant.

(6753-C)

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In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 350

NORTHWESTERN BELL TELEPHONE COMPANY,
Appellant,

vs.

NEBRASKA STATE RAILWAY COMMISSION,
Appellee.

APPEAL FROM THE SUPREME COURT OF THE STATE OF NEBRASKA

BRIEF FOR APPELLANT

FRANK E. RANDALL,
TRACY J. PEYCKE,
Counsel for Appellant.

CHARLES M. BRACELEN,
Of Counsel.

COCKLE PRINTING CO., LAW BRIEFS, OMAHA

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In the
Supreme Court of the United States

OCTOBER TERM, 1935

No. 350

NORTHWESTERN BELL TELEPHONE COMPANY,
Appellant,

vs.

NEBRASKA STATE RAILWAY COMMISSION,
Appellee.

BRIEF FOR APPELLANT

The appellant prosecutes this appeal from a judgment of the Supreme Court of the State of Nebraska rendered March 1, 1935, which became final on May 4, 1935, by reason of the denial on that date of a motion for a rehearing. This judgment affirmed an order of the appellee Commission made on April 9, 1934, purporting to fix the depreciation rate to be used by appellant in its accounting for the year 1934 at 3½ per cent upon all its depreciable property in the State of Nebraska.

OPINIONS IN THE COURT BELOW

The opinion of the Supreme Court of Nebraska in this cause was filed March 1, 1935, and is reported in *In re Depreciation Charges for Class A and Class B Telephone Companies: Northwestern Bell Telephone Company v. Nebraska State Railway Commission,* 128 Neb. 447, 259 N. W. 362 (R. 216-221).

This decision affirmed an order of the Nebraska State Railway Commission, which, with its accompanying report or opinion, is not officially reported, but which may be found reported in *Re Northwestern Bell Telephone Company,* 5 P. U. R. (N. S.) 20 (R. 19-31). Previous orders of the Commission in the same proceeding to which reference will be made are not officially or otherwise reported, except that the opinion or report of the Nebraska Commission which accompanied its order of November 29, 1933, hereinafter referred to, is reported in *Re Depreciation Charges for Telephone Companies,* 1 P. U. R. (N. S.) 264 (R. 2-10).

JURISDICTION

Appellant has complied with paragraph 1 of Rule 12 of the rules of this Court, and pursuant thereto has filed a separate statement disclosing the basis upon which it is contended that this Court has jurisdiction upon this appeal to review the judgment of the Supreme Court of Nebraska. The Court has noted probable jurisdiction.

STATEMENT OF THE CASE

The proceeding which culminated in the order of the Nebraska Commission (the Appellee) here in question (the order of April 9, 1934, above referred to) was initiated by the Commission by an order styled "General Order No. 59, In the Matter of Depreciation Charges for Class 'A' and Class 'B' Telephone Companies," entered on November 29, 1933 (R. 2-10).

This initial order corsists of a preliminary statement of seven pages (R. 2-9) and the *order proper* (R. 9-10).

Since an understanding of this initial order is important in its bearing upon the argument herein, a brief statement of its salient features should be made at the outset.

Summary of General Order No. 59

The statement accompanying General Order 59 refers to the authority vested in the Interstate Commerce Commission to regulate the accounting of telephone companies subject to the Interstate Commerce Act, and to the system of accounts which had been prescribed to be used by such companies on and after January 1, 1913. Section 20, Par. (5) of the Interstate Commerce Act was amended in 1920 to require the Interstate Commerce Commission to prescribe "the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property * * *." The statement refers to this amendment and to the proceedings had before the Interstate Commerce Commission looking toward the carrying out of this mandate of Congress which culminated in the final order of the Commission on July 28, 1931. *Depreciation Charges for Telephone Companies,* 177 I. C. C. 351.

As was pointed out in the statement referred to, the Interstate Commerce Commission had required Class A telephone companies, of which appellant is one, to file

on or before August 1, 1934, with state commissions having jurisdiction, estimates of composite depreciation rates for each of twelve classes of property specified as depreciable, in accordance with principles of estimate and calculation prescribed by the Interstate Commerce Commission. The purpose of the Interstate Commerce Commission to be accomplished by these filings with state commissions was to secure the consideration thereof by the state commissions and to procure from them recommendations as to proper rates of depreciation to be adopted by the Interstate Commerce Commission. The further procedure was stated as follows by the Interstate Commerce Commission:

> "After consideration of the recommendations of the State commission or commissions to the extent available, this Commission will by a temporary order prescribe the composite annual percentage rates which shall be charged with respect to each class of depreciable telephone plant." (Exhibit 7, R. 211; 177 I. C. C. 351, 446.)

The statement of the Nebraska Commission also recites the fact that the Interstate Commerce Commission had prescribed for use by Class A telephone companies on and after January 1, 1933, a Uniform System of Accounts for Telephone Companies, First Revised Issue (Exhibit 7). This accounting system included as instructions for depreciation accounting the same principles and provisions which had been adopted by the Interstate Commerce Commission as a part of the depreciation order of July 28, 1931. In postponing certain effective dates of the depreciation order, the Interstate Commerce Commission had expressly provided that such postponement should not relieve companies from accounting for

depreciation in the manner required by the system of accounts (R. 5). Reference is then made to Interstate Commerce Commission Depreciation Section Circular No. 7 requesting telephone companies to file with the Interstate Commerce Commission not later than March 1, 1934, a schedule of depreciation rates by primary accounts which the companies proposed to use during 1934, together with a statement of estimated service lives and salvage value "based upon the best information readily available" but without the supporting detail which had been required to accompany the filings to be made with the state commissions on or before August 1, 1934 (R. 5).*

Under the heading of "Jurisdiction" the Nebraska Commission in the statement accompanying the order of November 29, 1933, then discusses the federal statutes and the action taken pursuant thereto relating to depreciation accounting, and states its understanding of the authority of the state and federal governments respectively in this field (R. 6-8). Under the heading of "Procedure" the Nebraska Commission then stated:

> "The Commission is of the opinion and so finds that the procedure adopted by the Interstate Commerce Commission, for prescribing depreciation rates, should be adopted by this Commission, except that when the Interstate Commerce Commission shall have prescribed the rate of depreciation after hearings by this Commission and the recommendations of this Commission thereon, the said rate should not be final, as far as accounting to this Commission is concerned, but subject to review by this Commission and a final order entered thereon." (R. 9.)

* The Nebraska Commission misinterpreted this requirement of the Interstate Commerce Commission as calling for the filing of March 1, 1934, to be made with the state commissions (R. 7).

Further in this connection the Nebraska Commission stated that the principles which had been enunciated by the Interstate Commerce Commission in its depreciation proceedings "should be adopted by this commission as a basis for depreciation accounting" (R. 8).

Upon the basis of the recitals which have been summarized above, the Nebraska Commission, by its order of November 29, 1933, directed appellant, together with other Class A and Class B telephone companies, to file with the Nebraska Commission on or before March 1, 1934, a schedule of depreciation rates for use in 1934, together with such data as had been required by the Interstate Commerce Commission to be filed with it at that time. Furthermore, appellant with other Class A telephone companies was directed to file with the Nebraska Commission on or before August 1, 1934, the proposed rates to be used on and after January 1, 1935, in accordance with the requirements of the Interstate Commerce Commission as set forth in the order of that body of July 28, 1931, 177 I. C. C. 351, and of the Uniform System of Accounts, Instruction 80 (Exhibit 7, R. 210-211), and supplemental orders postponing the effective dates of these requirements. Paragraph 4 of the order of the Nebraska Commission of November 29, provided:

> "4. That the procedure adopted by the Interstate Commerce Commission for prescribing depreciation rates be and the same is hereby approved, except that this Commission reserves the right to review the findings and conclusions of the Interstate Commerce Commission and enter a final order thereon as to the depreciation rate for accounting purposes to this Commission." (R. 9-10.)

The foregoing rather extended statement of the recitals contained in the order of November 29, is made for the reason that the recitals thus restated here constitute facts material to consideration upon this appeal, and for the further reason that the statement of them in the order of the Nebraska Commission is in itself a material consideration to be examined in connection with the inquiry whether the order here appealed from could validly be made consistently with requirements of due notice and right to a hearing constitutionally guaranteed to the appellant.

Within the time directed by the Commission the appellant filed with it the schedule of depreciation rates proposed to be used in 1934 and supporting data in accordance with the requirements of the November 29th order (R. 9) directing that such material be filed on or before March 1, 1934.

These schedules set out the depreciation rates for each of twelve classes of property which had been specified by the Interstate Commerce Commission as subject to depreciation accounting (R. 10-17). This filing indicated for each such class of property the service lives and the percentages of salvage which were employed in computing the depreciation rates. These estimates and computations were made according to the methods prescribed by the Interstate Commerce Commission in its order in the depreciation proceeding and in the accounting system which it had made effective in 1933. These percentage rates are applied in computing depreciation to the investment in the several primary accounts to which they relate, and thus is derived for each account

the amount representing the expense of depreciation associated with the property embraced in that account. The total of these amounts is the total annual depreciation expense on account of all depreciable property. This total may be related to the aggregate investment in the twelve accounts covering depreciable property. The filing of March 1, 1934, showed that the dollars of depreciation produced by the application of the twelve different rates to their several accounts amounted to 4.48 per cent of the total investment in depreciable property as of January 1, 1934. The Commission speaks of this as appellant's proposed rate (R. 30). No such composite rate is actually employed in depreciation accounting, nor can it be consistently with the federal accounting system.

Order for Hearing

On March 6, 1934, the Nebraska Commission made and entered, and caused to be served upon appellant, an order in the following terms:

> "Pursuant to our order of November 29th, 1933, the Northwestern Bell Telephone Company has filed with the Commission its schedule of depreciation rates by primary accounts which it proposes to apply for the year 1934, together with the supporting data as required by the Interstate Commerce Commission in Schedules 1 and 2 of Circular 7, Depreciation Section Series, and the same having been examined by our Engineering staff and not being fully satisfied with the rates proposed, we find that the cause should be set down for hearing for oral examination of the members of respondent's staff, who prepared said schedules, and for the introduction of such evidence the Commission may desire to submit with opportunity of objections and cross-examination by respondent,

> "IT IS THEREFORE ORDERED that the cause be set down for hearing on the 19th day of March, 1934, at the hour of 10 o'clock A. M. at the Commission's hearing room in the State Capitol." (R. 17-18.)

Pursuant to this order, appellant caused the members of its staff who had to do with the preparation of the schedules which had been filed, to appear before the Commission on March 19th as directed, and these witnesses tendered themselves to the Commission for oral examination as directed by the order. At the opening of this hearing appellant's counsel stated to the Commission that appellant was then engaged in assembling and arranging the material which would constitute the data supporting its depreciation rates, and which both the Interstate Commerce Commission and the Nebraska Commission had required to be filed on or before August 1, 1934. It was stated that in view of the date thus fixed, this material was not then ready for presentation and consequently appellant would not undertake at that time to make any complete affirmative showing in support of its rates of depreciation, but construed the order of March 6th as directing the production of the persons who had compiled the summarized schedules required to be filed March 1, and that such witnesses were present and ready to answer such questions as might be asked them (R. 43, 45, 46). Accordingly a variety of questions were asked by the Commission and its representatives of Mr. T. H. Granfield, the appellant's Inventory and Costs Engineer, who had had charge of preparing the schedules, and of Mr. R. P. Baird, the Company's General Auditor. This hearing occurred on March 19th and March 20th, and was confined to the answering of questions and the

making of such explanations as the Commission and its Engineer requested of these witnesses. Following this, the Commission caused certain exhibits of its own to be introduced in evidence, which are part of this record as Exhibits 3, 4, 5 and 6 (R. 191-200). The Commission then requested the appellant to furnish certain further data after the adjournment of the hearing, which request was complied with (R. 151-153), and the hearing adjourned.

The appellant offered no evidence in its own behalf and there was no argument of any question before the Commission on that occasion. It was not considered by appellant or suggested by the proceedings that there was any issue before the Commission as to which either evidence or argument could be directed, but on the contrary, the character of the proceedings was plainly limited to the scope fixed by the order of March 6, that is, the oral examination of designated persons by the Commission and the submission of such evidence as the Commission might desire to introduce.

Order Appealed From

On April 9, 1934, the Nebraska Commission made and entered the order appealed from. This order as modified by a subsequent inconsequential change in phraseology, was in the following terms:

> "IT IS THEREFORE ORDERED by the Nebraska State Railway Commission that the composite depreciation rate of the Northwestern Bell Telephone Company be and the same is hereby fixed at 3½ per cent upon all of its depreciable property in Nebraska including right-of-way, for the year 1934.
>
> "IT IS FURTHER ORDERED that the Northwestern Bell Telephone Company be and is hereby directed to

use a composite rate of 3½ per cent upon all of its depreciable property in Nebraska including right-of-way, for the year 1934, for purposes of accounting and reporting to the Nebraska State Railway Commission." (R. 30-31, 35.)

It was accompanied by an opinion and findings (R. 19-30).

Motion for Rehearing Before Commission

Appellant promptly filed a motion to vacate the order and for a rehearing or a new trial. In this motion (R. 31-32) appellant asserted that the order was made without proper notice or hearing and was therefore invalid; that the Commission had no jurisdiction to make such an order inasmuch as it was in conflict with properly exercised federal authority; and that it was not sustained by the evidence and was contrary to law. The Commission set this motion down for oral argument, but on May 15, 1934, overruled the motion, one commissioner dissenting (R. 34-41).

Appeal to Nebraska Supreme Court

Thereupon appellant took an appeal to the Supreme Court of Nebraska pursuant to the statutory provisions providing for a review of orders of the Commission under Section 75-505, Compiled Statutes of Nebraska, 1929. Substantially the same contentions were urged by appellant before the Supreme Court as have been enumerated above, as the grounds of its motion for a rehearing before the Commission. In an opinion filed March 1, 1935, the Supreme Court of Nebraska affirmed the order of the Commission and the appeal to this court followed in due course after the making and overruling of a motion for rehearing before the Nebraska Supreme Court.

SPECIFICATIONS OF THE ASSIGNED ERRORS HEREIN URGED

1. The Supreme Court of Nebraska erred in holding the order of April 9, 1934 valid as against the contention that it violated the rights of appellant under the Fourteenth Amendment in that the order was made without notice to appellant and without affording to appellant an opportunity to be heard. Assignment of Error No. 1 (R. 224).

2. The Supreme Court of Nebraska erred in affirming said order as against appellant's contention that the regulation of the subject matter there involved had been vested by Congress exclusively in the Interstate Commerce Commission, and the Interstate Commerce Commission had fully covered the regulation of the accounting of appellant, thereby precluding any regulation of the same matter by state authority. Assignment of Error No. 2 (R. 224-5).

3. The Supreme Court of Nebraska erred in affirming the order as against appellant's contention that the order was invalid because in conflict with valid and binding regulations and requirements imposed upon appellant by the Interstate Commerce Commission. Assignment of Errors Nos. 3 and 4 (R. 225).

4. The Supreme Court of Nebraska erred in affirming said order as against appellant's contention that it deprived appellant of its property without due process of law in that the order prescribed the use of a depreciation rate without any evidence to support the propriety of such rate; in that appellant was thereby deprived of the right to keep a true record of the expenses of its

business; and in that the method adopted by the Commission in determining upon the depreciation rate prescribed, was unsound and upon its face calculated to produce a rate other than the true rate of depreciation. Assignment of Errors 5, 6 and 7 (R. 225-226).

ARGUMENT

Summary of Argument

I. The order is invalid because it was made in disregard of the requirements of due process of the Fourteenth Amendment of the Constitution of the United States, in that said order was made without such notice and hearing as is thereby guaranteed to appellant.

A. The Nebraska Commission was bound to observe the requirements of procedural due process as to notice and hearing because upon any judicial review of the order all questions must be decided upon the record made before the Commission.

B. The requirements of due process respecting notice and hearing were not observed in the proceedings before the Commission.

1. There was no notice that the Commission contemplated the making of any order affecting the rates of depreciation to be used by appellant in its accounting in 1934.

2. On the contrary, the previous proceedings before the Commission were inconsistent with the making of such an order.

a. No purpose had been disclosed except to secure information for the purpose of making recommendations to the Interstate Commerce Commission.

b. The Nebraska Commission had adopted the principles and procedure contemplated by the Interstate Commerce Commission.

c. It could not make an order such as the one at bar consistently with the principles thus adopted.

d. It had expressly announced its intention to defer determining any issue as to conflicting state and federal jurisdiction until the Interstate Commerce Commission should have finally fixed rates of depreciation.

3. The proceedings did not afford appellant a legally sufficient hearing.

a. There being no notice adequate to support the order, the hearing held pursuant to the particular notice given was insufficient because it was not a hearing upon the matters which should have been heard to justify the order.

b. Appellant had no opportunity to make a showing by evidence or argument as to the legality or propriety of such an order.

4. There was no waiver by appellant of the insufficiency of notice or hearing because such insufficiency did not appear until the order was made.

II. The order is invalid because it was beyond the power and jurisdiction of the Nebraska Commission under the Constitution of the United States for the reason that the action already taken by the federal government respecting the accounting by appellant for depreciation, completely occupied the field of regulation of that subject and precluded any regulation thereof by state authority.

A. Federal statutes and regulations discussed.

B. The validity of such federal regulation of accounting of carriers engaged in interstate commerce, respecting both local and interstate business, has been established.

C. The order here in question is an attempted regulation of accounting of such a carrier.

D. The authority exercised by Congress and by the Federal Commission under its authority respecting the regulation of accounting of such carriers makes invalid the action attempted to be taken by the order here under consideration.

III. The order is invalid under the Constitution of the United States because it is in conflict with valid regulations of the Interstate Commerce Commission relating to the same subject.

A. Particular federal requirements considered.

1. Accounting separately by classes of plant.
2. Straight-line depreciation accounting.
3. Depreciation rates to be based on estimated service values and service lives.

IV. The order is invalid under the Fourteenth Amendment because

A. It deprives appellant of the right to maintain true and accurate records of the expenses of its business;

B. It is not supported by any substantial evidence, and

C. It requires the use in the accounts of appellant of a depreciation rate which was less than the true rate for the sole purpose of reducing the balance in its depreciation reserve account.

I.

THE ORDER APPEALED FROM IS VOID UNDER THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT OF THE CONSTITUTION OF THE UNITED STATES BECAUSE IT WAS MADE WITHOUT NOTICE TO APPELLANT OF THE ISSUE TO BE EXAMINED AND OF THE NATURE OF THE ACTION CONTEMPLATED, AND WITHOUT AFFORDING TO APPELLANT AN OPPORTUNITY FOR HEARING THEREON.

A.

The Nebraska Commission could not validly make the order in question without observing the requirements of due process as to notice and hearing for the particular reason that under the Statutes of Nebraska any judicial review of the order must be had solely upon the record made before the Commission.

Under the provisions of Compiled Statutes of Nebraska, 1929, Section 75-505, the method of judicial review of such an order is by an appeal to the Supreme Court. This section of the statute provides:

> "The evidence presented before the railway commission, as reported by its official stenographer and reduced to writing, shall be duly certified to by the stenographer and the chairman of the railway commission as the true bill of exceptions, which, together with the pleadings and filings duly certified in the case under the seal of the railway commission, shall constitute the complete record and the evidence upon which the case shall be presented to the appellate court."

It results from this that the parties concerned must make before the commission whatever record is to be made in such proceeding. This scheme of review of administrative orders is too commonly employed to require any special comment. However, the consideration is inevi-

tably associated with this method of procedure that any denial of procedural due process before the commission is final. A proper notice must there be given or it can never be given. A proper hearing must there be had or in the nature of things it will never be had. If these incidents of a procedure in accordance with due process of law are not observed by the commission, then there has been a final failure to observe them in making up the only record which can be considered upon a judicial review of an order. These rights in that case have been denied at the only point which the state has chosen to provide for their exercise.

It is clear that if in any particular proceeding the Nebraska Commission is permitted to make orders affecting important property rights without itself observing the essentials of due process in its procedure, there has been an unconstitutional deprivation of rights in this regard. Compare *Oregon R. R. & N. Co. v. Fairchild*, 224 U. S. 510, 524-526.

B.

The requirements of due process respecting notice and hearing were not observed in the proceedings before the Commission.

Any right of the appellant to test judicially the legality of such an order as the one here in question must be made upon the record before the Commission. No other evidence may be introduced or considered. It necessarily follows from this that appellant cannot be precluded by such an order unless it was notified in advance of what the issue was which was to be heard, and in respect to which evidence was to be adduced.

In this connection this court took occasion to say in *Oregon R. R. & N. Co. v. Fairchild,* supra:

> "The defendant insists, however, that, no matter how complete the right to be heard before the Commission, the statute having denied all other opportunity for testing the validity of the order in the state courts, furnished an utterly inadequate judicial review because, as the carrier could not anticipate what decision would be made, it was unjust to require it to produce evidence, to show in advance, the unreasonableness of an order, the terms of which were not known. From this it argues that the statute was unconstitutional in so far as it prevented the court from receiving competent and non-cumulative testimony tending to prove that there was no public necessity for making the track connection and that the order was void.
>
> *"This position would be true if the defendant had not been put on notice as to what order was asked for and then given ample opportunity to show that it would be unjust or unreasonable to grant it.* In this case under the statute, it was given such notice." (Italics ours.) 224 U. S. at pp. 525-526.

1.

There was no notice in this proceeding that the Commission had in contemplation the making of any order affecting the accounting in 1934 by appellant for the expense of depreciation.

The document which set the matter down for hearing on March 19 and 20, 1934, has been quoted in the foregoing statement of facts in this brief and is found at pages 17-18 of the printed record. It set the pending matter, whatever it was, down for hearing at a specified time for the oral examination of certain designated persons who had prepared some schedules filed with the

Commission, and for the introduction of evidence by the Commission. The preceding course of this matter before the Commission had given it a well defined character as one looking toward the making of recommendations by the Commission to the Interstate Commerce Commission. The order for the hearing of March 19 set this "cause" down for hearing at that time.

The notice does not contain any charge or complaint of any character. It does not assert that appellant is doing or contemplating anything unlawful or anything which the Commission has either the wish or the power to correct or remedy. In short, there is nothing in this notice which suggested any controversy between any persons whatever, or any issue to be tried or determined. The notice refers to the filing of certain proposed schedules of depreciation rates by appellant, and recites that the Commission is not fully satisfied. This surely falls far short of suggesting any issue which was to be resolved by the making of an order by the Commission. It will be remembered that the request of the Interstate Commerce Commission in compliance with which the filing of March 1, 1934 was made, contemplated only the furnishing of such data as to service lives and salvage values as might be "readily available" (R. 5), and was not designed to "satisfy" any one in the sense of making out a case for their approval by public authority. This was left for the filings to be made August 1, 1934. The statement referred to is properly consistent only with the continuance of the declared purpose of the Commission to inform itself as to these matters to the end which it had previously very fully set forth.

2.

The Order of November 29, 1933, of the Nebraska Commission giving notice of the proceeding and the whole course of the proceedings in the matter then before it were inconsistent with the making of the order appealed from.

In this connection we direct attention to the order of November 29, 1933, which initiated the proceeding in the course of which the order appealed from was made, and which fully set forth the nature and purpose of the proceeding. In the foregoing statement of facts we have set out the statements contained in this order and in the opinion on which it was based. The purpose of the proceeding is thereby fully and clearly disclosed.

(a)

The purpose of the proceeding had been disclosed to be that of securing information for the purpose of making recommendations to the Interstate Commerce Commission, and no other purpose had been suggested.

Ever since January 1, 1913, telephone companies engaged in interstate commerce, and therefore subject to the Interstate Commerce Act, have been required by the Interstate Commerce Commission to keep their accounts in accordance with the uniform system prescribed by the Federal Commission. This was under the authority of Section 20, Paragraph (5) of the Interstate Commerce Act, 49 U. S. C. A. Sec. 20, Par. (5), and Sec. 20, Par. (1). Under this system of accounts telephone companies were directed to account for depreciation and certain rules and principles were established in accordance with which such accounting should be performed.

By the Transportation Act of 1920 an amendment was adopted to Section 20, Paragraph (5) of the Interstate Commerce Act, which inserted the following provision:

> "The commission shall, as soon as practicable, prescribe, for carriers subject to this chapter, the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this chapter shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses."

Although the Interstate Commerce Commission had, as indicated above, previously prescribed rules in accordance with which depreciation accounting should be done, it had never undertaken to prescribe the specific rate or rates of depreciation which should be employed. The amendment of 1920 required that it proceed to specify the classes of property which were to be treated as depreciable and the specific rates of depreciation to be charged with respect to each. Extensive hearings were held. A series of intermediate reports and a final report and order were made. The latter is *In the Matter of Depreciation Charges for Telephone Companies,* 177

I. C. C. 351. At this time the Commission determined the classes of property as required by the Act and made elaborate findings and laid down detailed rules and principles to be followed in calculating depreciation rates.

Looking to the actual establishment of such rates by the Interstate Commerce Commission the carriers affected were directed to file with state commissions on or before specified dates, estimates of the percentage rates applicable to the several classes of property, such estimates to be made in accordance with the principles established by the Interstate Commerce Commission and to be accompanied by a sworn statement showing the underlying data upon which they had been computed. 177 I. C. C. 445, 446. It was contemplated that state commissions upon the basis of the filings so made would make recommendations to the Interstate Commerce Commission, which would then proceed to make a temporary order fixing rates, and subsequently after public hearings, if necessary, a final order fixing rates. 177 I. C. C. 446. Effective January 1, 1933, the Interstate Commerce Commission prescribed a revised accounting system for telephone companies (Exhibit 7, R. 201-214). In this accounting system the principles and procedure for determining depreciation rates as above outlined were made a part of the accounting regulations.

Orders were subsequently made postponing from time to time the dates when filings with the state commissions were to be made, and at the time with which we are concerned, such filing was to be made August 1, 1934. The order of the Nebraska Commission of November 29, 1933, dealt with this procedure and indicated the

determination of the Commission to perform the functions contemplated by the order of the Interstate Commerce Commission, that is, to make recommendations to the Interstate Commerce Commission. It added the sanction of its order to that of the Interstate Commerce Commission with respect to the filing of proposed rates and data supporting the same with the Nebraska Commission.

As appears from the previous description of this order the Nebraska Commission had plainly characterized the proceeding which it then initiated as one designed to co-operate with the Interstate Commerce Commission in enabling the latter to carry out the mandate of Congress and prescribe depreciation rates.

(b)

The Nebraska Commission adopted the principles and procedure which the Interstate Commerce Commission had laid down.

It is not necessary in this connection to do more than refer to the provisions of the order of November 29, 1933, as they have already been summarized and quoted in this brief, to have it clearly appear that the Nebraska Commission was at pains to be explicit in placing itself in complete harmony for the purposes of this proceeding with the principles and regulations of the Interstate Commerce Commission. The pertinency of this fact in this connection is that with this background appellant was entitled to expect that unless the Nebraska Commission evidenced some change in its purpose it would make no orders or impose no requirements inconsistent with those

which had been promulgated by the Interstate Commerce Commission.

(c)

The present Order is inconsistent with the principles and requirements of the Interstate Commerce Commission and is therefore inconsistent with the principles which the Commission had in this very proceeding formally announced that it embraced and adopted.

We leave for more elaborate discussion in connection with another ground of attack upon this order, the conflicts between this order and the requirements of the Interstate Commerce Commission. For the bearing of these inconsistencies upon the matter of due notice, we only refer summarily to them at this time. It will be sufficient now merely to point out:

1. The requirements of the Interstate Commerce Commission respecting depreciation accounting impose the necessity of employing a separate rate for each of twelve classes of property (R. 211, 213). The order of the Nebraska Commission requires the employment of a single rate for all depreciable property.

2. The requirements of the Interstate Commerce Commission are that each of such rates be computed upon the basis of estimated service lives and salvage values (R. 211). The order in question requires the use of a rate which has no demonstrable or even conceivable basis in estimated service values and service lives, but on the contrary, as the report of the Commission discloses, is arrived at upon entirely different principles.

3. The Interstate Commerce Commission requires that depreciation rates be computed in accordance with the straight-line method of depreciation accounting (R. 211). The Nebraska order disregards this requirement and requires the employment of a rate which necessitates a departure from straight-line depreciation accounting.

Thus it is seen that the effect of what had taken place was that appellant had been plainly notified by the Commission that whatever it did would be in accordance with the principles of depreciation accounting which had been established by the Interstate Commerce Commission and would be for the purpose of making recommendations to that Commission. What it in fact did was to make an order having no function in connection with making recommendations to the federal Commission, and which was in almost every essential particular at variance with these principles.

(d)

The Nebraska Commission had clearly announced its intention to make no order having to do with any question as to jurisdiction as between State and Federal authority until after the fixing of rates of depreciation by the Interstate Commerce Commission had been fully accomplished.

The order of November 29, 1933, declared, in Paragraph 4 of that order, that the Nebraska Commission approved the procedure adopted by the Interstate Commerce Commission reserving only "the right to review the findings and conclusions of the Interstate Commerce Commission and enter a final order thereon as to the depreciation rate for accounting purposes to this Commission" (R. 9-10). There could scarcely have been

enunciated a clearer or more definite statement of what the Commission was about, nor could there have been a more definite assurance to parties concerned that until the Interstate Commerce Commission had acted, the Nebraska Commission would not undertake to impose requirements which might be at variance with those of the federal Commission, and thereby subject such parties to the oppression which is always incident to an attempted exercise of authority by two conflicting jurisdictions respecting the same subject matter.

3.

Appellant was not given a hearing which satisfies the requirements of due process.

The character of the hearing which preceded the making of this order is not to be divorced from the character of notice which preceded the hearing. The insufficiency of the hearing resulted primarily from the fact that appellant had been given no notice sufficient to advise it that an order regulating depreciation accounting was in contemplation at all. It is elementary that a constitutionally sufficient hearing must afford an opportunity to a party to address itself by evidence and argument to the issue or issues which are to be resolved by the decision of the particular tribunal. Of course, a hearing may be adequate to deal with one matter and yet entirely inadequate to support an order dealing with some foreign issue or consideration. Appellant did not have a proper hearing in this case because it had not been advised that the occasion for the hearing had anything to do with an order of the kind which the Commission issued and therefore had no opportunity to present evidence or make argu-

ments as to either the legality or propriety of the making of such an order.

Moreover, the order of March 6, 1934, which set the matter down for hearing, is worthy of attention in this respect (See supra, p. 9). This order did not call upon appellant to show cause with respect to any question or set down any specified issue for hearing. On the contrary, it simply directed the production of certain individual witnesses for questioning by the Commission, and stated that the Commission might present evidence. It can scarcely be considered an adequate hearing in any case where the tribunal selects the witnesses and limits the evidence to that which it sees fit to introduce. Compare *Whitfield v. Hanges,* 222 Fed. 745, 749. This court said in *The New England Divisions Case,* 261 U. S. 184, at p. 200:

> "A full hearing is one in which ample opportunity is afforded to all parties to make, by evidence and argument, a showing fairly adequate to establish the propriety or impropriety, from the standpoint of justice and law, of the step asked to be taken."

4.

There was no waiver by appellant of its right to proper notice and a full hearing by its participation in the proceedings which were had.

The point in this connection is that the notice and the hearing were entirely appropriate to the proceedings at that time pending before the Commission. The Commission had initiated a proceeding for the purpose of assembling information and acquainting itself with the matter of appellant's depreciation rates with the end in view of making recommendations to the Interstate Com-

merce Commission. It had elaborately so described the matter in its order of November 29, 1933. One step in the course of the proceedings looking to the ultimate establishment of depreciation rates by the Interstate Commerce Commission, involved the filing on or before March 1, 1934, of rates proposed to be used during that year. At this stage the Nebraska Commission, having these data before it, directed appellant to produce certain witnesses at a hearing which it proposed to conduct. This was well within the bounds of action contemplated by all of the parties as a part of what the Nebraska Commission was engaged in doing.

Appellant construed this hearing as possessed of the same underlying character which the proceedings had had since their institution. There was nothing in the order setting the matter down for hearing which intimated that the proceedings had changed or that anything was involved other than the steps previously contemplated of placing the Nebraska Commission in a position to make recommendations to the Interstate Commerce Commission.

The hearing of March 19 and 20, 1934, simply carried out what the notice of the hearing had foreshadowed. Appellant had no objection to this procedure and readily co-operated in the furnishing of such information as the Commission at that time sought to elicit. The scope of the hearing was exactly what the appellant had been notified that it would be. The objection which now lies to the order in suit, the order of April 9, 1934, fixing a rate of depreciation, is that this order was outside the scope of both the notice and the hearing. It was not contemplated by either, or by the proceedings which had antedated the hearing.

Appellant promptly (April 12, 1934) filed a Motion for Rehearing (R. 31-2). This motion in the most definite manner called the Commission's attention to the foregoing glaring irregularity in the proceedings. It advised the Commission that no notice had been given to the company that the proceeding contemplated fixing a rate or rates of depreciation, or contemplated any action whatever by the Commission other than making its recommendations to the Interstate Commerce Commission. It pointed out that the only thing the Company had been notified to do was to present the members of its staff who had prepared the schedules for oral examination by the Commission. It asked that the order be set aside and the whole matter be reopened, so that the company might have an opportunity both to challenge the Commission's authority to make such an order and to present evidence to justify the depreciation rates it had filed. *This motion was denied.*

The character of this hearing was accurately described by the Commissioner who dissented upon appellant's application for a rehearing, in the following language:

> "It was common knowledge that the two day hearings on March 19th and 20th, 1934, were considered by members of the Commission as a 'school of instruction,' and by the respondent as a compliance to an order by the Commission to demonstrate to it some of the methods, plans, etc., which were going to be used in 'proving in' the life of property in hearings before the Interstate Commerce Commission. The respondent offered no testimony. The Commission questioned several of its employees as to the work they were doing. Certainly there was no hearing

which must be contemplated in view of any final order of this Commission." (R. 40-41.)

II.

THE ORDER APPEALED FROM IS VOID FOR THE REASON THAT THE ACTION ALREADY TAKEN BY THE FEDERAL GOVERNMENT RESPECTING THE ACCOUNTING BY APPELLANT FOR DEPRECIATION COMPLETELY OCCUPIED THE FIELD OF REGULATION OF THAT SUBJECT AND PRECLUDED ANY REGULATION THEREOF BY STATE AUTHORITY

The proposition which we are concerned to establish at this point is that the order appealed from is invalid for the reason that it is an attempt by state authority to regulate the business of an interstate carrier in an area which has been so far occupied by federal authority as to preclude state regulation.

When the order here being reviewed was made, appellant was subject to the Interstate Commerce Act. The validity of the order is to be tested by the considerations then pertinent.*

Congress had vested in the Interstate Commerce Commission full and complete power to prescribe and regulate the accounting forms and methods of telephone companies and others subject to the Interstate Commerce Act. Pursuant thereto the Interstate Commerce Commis-

* Later in 1934 the Federal Communications Act was enacted, (Act of June 19, 1934, c. 652, 48 Stat. 1064, 47 U.S.C.A. Secs. 151-609). Some later reference may be made to this Act, but in the course of the discussion to follow the matter is argued in the light of the federal statutes previously applicable, without taking occasion to notice whether federal requirements now have sanctions proceeding from statutes and orders superseding those by which this order must be tested.

It may be added that the Communications Act (Sec. 220) vests in the Federal Communications Commission the same authority over accounting in general and depreciation accounting in particular as the Interstate Commerce Act had previously vested in the Interstate Commerce Commission. This is of interest as indicating the continuing importance of the questions here presented for argument.

sion had prescribed a system of accounts for telephone companies subject to its authority. This accounting system, uniform as to companies of the classes affected, is a complete set of regulations dealing with the accounting of such carriers. It covers all the accounting of these companies. The Interstate Commerce Act, Section 20, Paragraph (5) and Paragraph (7), forbids carriers subject to the Act, under criminal penalties, to keep any other records or accounts than those prescribed or authorized.

By virtue of the action thus taken, the federal authority has completely occupied the field of regulating the accounting of carriers subject to the Interstate Commerce Act. The system prescribed is complete, and, by enjoining carriers from keeping any other accounts, the federal Act has made it plain that the system of accounts is to be free of interference from any source whatever. It follows that any state regulation of the same subject, i. e. the accounting of carriers subject to the Interstate Commerce Act, becomes legally impossible.

A.

Federal Statutes and Regulations considered.

Some reference has already been made in another connection to the pertinent provisions of the Interstate Commerce Act. By Act of Congress of June 18, 1910, telephone companies engaged in interstate commerce were made subject to the provisions of the Interstate Commerce Act. U. S. C. Title 49, Section (1), Paragraph (1) (c). Section 20, Paragraph (1), provides that the Interstate Commerce Commission

"may, in its discretion, for the purpose of enabling it the better to carry out the purposes of this chapter, prescribe a period of time within which all common carriers subject to the provisions of this chapter shall have, as near as may be, a uniform system of accounts, and the manner in which such accounts shall be kept." (U.S.C. Title 49, Sec. 20, Par. (1).)

Section 20, Paragraph (5), of the Interstate Commerce Act further provides:

"The commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this chapter, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys."

This paragraph further provides:

"* * * and it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed or approved by the commission, * * *." (U.S.C. Title 49, Sec. 20, Par. (5).)

Paragraph (7) of this section provides:

"Any person * * * who shall willfully neglect or fail to make full, true, and correct entries in such accounts, records, or memoranda of all facts and transactions appertaining to the carrier's business, or shall keep any other accounts, records, or memoranda than those prescribed or approved by the commission, shall be deemed guilty of a misdemeandor and shall be subject, upon conviction in any court of the United States of competent jurisdiction, to a fine of not less than $1,000 nor more than $5,000, or imprisonment for a term not less than one year nor more than three years, or both such fine and imprisonment." (U.S.C. Title 49, Sec. 20, Par. (7).)

Pursuant to the authority thus conferred upon it, the Interstate Commerce Commission, effective January

1, 1913, prescribed a Uniform System of Accounts for Telephone Companies. Effective January 1, 1933, the Interstate Commerce Commission prescribed a revised system of accounts known as Uniform System of Accounts for Telephone Companies, First Revised Issue (Exhibit 7, R. 201-202). The order of the Commission placing this system in effect prescribed the same for use of telephone companies, including appellant, and ordered

> "that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all accounts in conformity therewith." (R. 201.)

Whereas the original system of accounts had directed companies to account for depreciation in accordance with rules to be adopted by the accounting company, the revised system of accounts directed such companies to account for depreciation in accordance with elaborate rules prescribed in the system of accounts. This system of accounts directed that until specific rates of depreciation for each account should be prescribed by the Commission,

> "the company's estimates of composite annual percentage rates computed in accordance with instruction 80 shall be used prior to the date rates prescribed by this Commission become effective." (Instruction 81 (C), R. 212-213.)

Instruction 80 directed, among other things, the following:

> "These percentage rates shall be based upon the estimated service values and service lives developed by a study of the company's history and experience and such engineering and other information as may be available with respect to prospective future con-

ditions. These percentage rates shall be computed in conformity with the group plan of accounting for depreciation and shall be such that the loss in service value of the property, except for losses excluded under the definition of depreciation (note instruction 3-J), may be distributed under the straight-line method (note instruction 3-Z) during the service life of the property. Such percentage rates shall for each primary account comprised of more than one class of property produce a charge to operating expenses for that account equal to the sum of the amounts that would otherwise be chargeable for each of the various classes of property included in the account." (R. 211.)

The result of the foregoing is that the Interstate Commerce Commission, pursuant to authority vested in it, had prescribed the forms and methods by which depreciation expense should be calculated for the purpose of accounting and the manner in which the accounting company should deal with it upon its books of account.*

B.

The Constitutional validity of Federal Regulation of the accounting of carriers engaged in interstate commerce, as respects all business both interstate and intrastate, has long since been established.

The action taken as disclosed by the foregoing recital of federal statutes and administrative regulations, discloses the sweeping nature of what has been done. The practical necessity of having but one system of accounts and but one source of regulation of the accounting of carriers engaged in both interstate and intrastate com-

* It may be proper to remark further that the Federal Communications Commission has revised the System of Accounts for Telephone Companies, effective January 1, 1936, and has provided for depreciation accounting and the computation of depreciation rates in accordance with the same principles which have been described above as having been adopted by the Interstate Commerce Commission.

merce is apparent in view of the fact that the same facilities and the same personnel are almost constantly engaged in both kinds of business. In the telephone business almost all property commonly thought of as provided for local use is at times used and is at all times available for use in interstate commerce. The two are inseparable. Compare *Cooney v. Mountain States Tel. & Tel. Co.*, 294 U. S. 384; *Board of Commissioners v. N. Y. Telephone Co.*, 271 U. S. 23. Consequently, the Interstate Commerce Commission in undertaking to regulate the accounting of carriers subject to its jurisdiction has never attempted to limit the scope of its requirements to the accounting for interstate business, but has, as would seem to be necessary, provided regulations covering the whole system of accounts of such carrier. The constitutional propriety of such regulation has long since been firmly established. *Interstate Commerce Commission v. Goodrich Transit Co.*, 224 U. S. 194; *Kansas City So. Ry. Co. v. United States*, 231 U. S. 423.

C.

The Order of the Nebraska Commission is an attempted regulation of accounting.

The order directed appellant "to use a composite rate of 3½ per cent upon all of its depreciable property in Nebraska including right-of-way, for the year 1934 for purposes of accounting and reporting to the Nebraska State Railway Commission." We may lay to one side the requirement as relating to the reporting to the Commission, and confront the direction to use the prescribed rate "for purposes of accounting." This plainly was a mandate as to how appellant should account for depre-

ciation upon its books. The proceeding in the course of which the order was made was concerned with depreciation expense solely as a matter of accounting. No proceeding was in progress or contemplated which related to charges to be made to the public for service.

The Supreme Court of Nebraska construed the order, as the parties before it also did, as a regulation of depreciation accounting (R. 217-219). *Northwestern Bell Telephone Co. v. Nebr. State Ry. Comm.*, 128 Neb. 447, 259 N. W. 362, 363, 364. The order as so construed is the order as it comes before this court. What the order called upon appellant to do was solely concerned with the entries to be made upon its books of account, and the reporting to the Nebraska Commission of what its books thus should reveal. The thing directed to be done was the making of accounting entries in a certain manner and upon the basis of calculations made in a prescribed fashion. Its validity must be tested in the light of the question whether the Nebraska Commission has the power to direct the manner and prescribe the basis upon which accounting entries covering depreciation expense shall be made. It is very plain that "depreciation" as it presents itself in this case is purely *depreciation accounting.*

It may be observed that the order of November 29, 1933 speaks of a "uniform system of accounting to the Interstate Commerce Commission" (R. 6), and of "depreciation charges for accounting purposes to this Commission" (R. 6). We do not undertake to interpret this language beyond saying that it seems to look to some system of multiple sets of accounting records maintained for the benefit of various regulatory bodies. Explaining

the concept which the Commission may have entertained perhaps helps to understand the order here being reviewed; but it cannot aid in sustaining it. The federal authority has regulated accounting, for whatever purpose accounting is done, and for the benefit of all to whom such accounts may be of any lawful concern. And it has expressly forbidden carriers to keep any other accounts or records.

A reading of the several orders of the Commission in this proceeding discloses a disposition to treat accounting as a function or part of the process of *reporting* to regulatory bodies. Of course, what a company is permitted to record may limit what it will be able to report. But accounting is a significant thing in itself. It has been made subject to federal regulation as an important function of a business which itself may properly be subjected to federal regulation, and not merely as a phase of making reports to commissions.

D.

The authority exercised by Congress and by the Interstate Commerce Commission pursuant to its authority has fully occupied the field of regulating the accounting of carriers engaged in interstate commerce and precludes any State action undertaking to regulate such accounting, and therefore the Order appealed from is invalid.

As the foregoing discussion discloses, Congress has authorized the Interstate Commerce Commission to prescribe the accounting methods to be employed by appellant and other carriers. The Interstate Commerce Commission has prescribed such accounting, including the calculation and recording of the expense of depreciation.

This action on the part of the federal authority not only covers fully the whole subject of accounting, but the provisions of the Interstate Commerce Act make it plain that the federal occupancy of this field should be exclusive. The institution of a "uniform system" of accounting, by the very force of these words, forbids the intrusion of authority by one or more of several states. Uniformity could not be expected long to withstand the effects of control by several different regulatory bodies. It must have been perfectly well understood that there are many plans and methods of accounting. The Interstate Commerce Commission could adopt a uniform system, or any system, only by the adoption of one of many alternative methods and the implied rejection of others. This is nowhere better illustrated than with respect to depreciation accounting. The existence of authority in one place to select and enforce the use of one method cannot be reconciled with the existence elsewhere of authority to select and enforce the use of a different one. In dealing with this question we are not left to inference as to whether Congress considered it desirable that a uniform system of accounting should prevail among carriers throughout the country. Compare *New York Central R. Co. v. Winfield*, 244 U. S. 147, 149, and dissenting opinion, p. 169. The thing which Congress has authorized the Interstate Commerce Commission to do is to make such accounting uniform.

If there were otherwise any question as to the existence in the states of any power to regulate any part or phase of the accounting of carriers subject to the Interstate Commerce Act, it would be removed by the provision of the Act forbidding carriers "to keep any other

accounts, records, or memoranda than those prescribed or approved by the Commission" (Sec. 20, Par. (5)). Congress could not have said more clearly that the regulations prescribed by the Interstate Commerce Commission should be exclusive.

It will be apparent from the foregoing statement of the argument, that appellant's position does not depend upon anything which is peculiar to depreciation as a subject of accounting. It is not the nature of the subject matter or facts that are to be recorded upon the books which is characteristic of the exercise of federal authority. Jurisdiction of accounting does not here depend upon jurisdiction to regulate the transactions which are being accounted for. Hence it is that the argument here made does not look for any essential foundation to the amendment of Section 20, Paragraph (5) of the Interstate Commerce Act by the Transportation Act of 1920, which directed the Interstate Commerce Commission to determine the classes of property for which depreciation should be charged as an expense, and to fix the rates of depreciation to be charged with respect to each class. See supra p. 21. Whether or not this amendment added anything to the authority previously possessed by the Commission, it must be admitted that there is no obstacle to its authority to prescribe the method of accounting, including the accounting for depreciation expense. The field that has been occupied is that of the regulation of accounting.

The completeness with which the federal government has undertaken the regulation of accounting of carriers subject to the Interstate Commerce Act would seem hard-

ly to leave any place for state action in this field. The only suggestion which has been made to the contrary looks for its authority to *Smith v. Illinois Bell Telephone Co.*, 282 U. S. 133. The Supreme Court of Nebraska decided this question adversely to appellant in reliance upon that case. We submit that this view proceeds from an essential misconception of what was there involved and decided.

It is important to keep clearly in sight the question with which we are dealing. Appellant's contention here is that Congress, pursuant to its authority to regulate interstate commerce, has, by statute and through its agency the Interstate Commerce Commission, prescribed the methods of accounting of telephone companies subject to the federal act. The action thus taken is such as to occupy this field and preclude any state regulation of accounting of such companies. The question now for consideration is whether the *Illinois Bell Case* stands in the way of accepting the result of this argument. In the present case we have urged the importance of seeing that the federal action taken is a regulation of accounting, complete and exclusive in character; and that the order of the Nebraska Commission is likewise an attempted regulation of accounting. They operate in the same field and deal with the same thing.

When we turn to *Smith v. Illinois Bell Telephone Co.*, it is found that the state action in question there was not a regulation of accounting at all. The authority asserted by the state was that of prescribing charges for intrastate service. No question existed as to the power of the state to function in this field. The determination by a

commission of proper charges for service, and the determination by a court of the validity of such charges, where challenged upon the ground of confiscation, involves the ascertainment of the expenses of furnishing such service, including the expense of depreciation. The question there was whether the state commission, or, as the matter then came up, the court resolving the issue of confiscation, should make its own findings as to the amount of the expense of depreciation, or whether by virtue of the federal action taken with respect to depreciation accounting the amount of depreciation expense was predetermined. The argument of the Telephone Company there was that in an intrastate rate case the matter was not open to independent investigation.

That contention was rejected by this court. The question was reserved for consideration when it might arise as to what the result would be after the Interstate Commerce Commission should have proceeded further in the performance of the duty imposed upon it by the amendment of 1920. The court said:

> "As the Interstate Commerce Commission has not acted finally in the matter, we are not now called upon to consider the scope of its authority in relation to depreciation charges, but we are of the opinion that, in any event, until action has been taken which could be deemed validly to affect the amount to be charged to depreciation in connection with intrastate business so as to affect intrastate rates, the prerogative of the State to prescribe such rates, and the jurisdiction and duty of the statutory court in considering their validity to determine the amount properly allowable for depreciation in connection with intrastate business, are not to be gainsaid." (282 U. S. 133, 159, 160.)

It is here apparent that on the face of the matter the state and federal actions which were claimed to be opposing one another dealt with different concerns. This court clearly recognized this when it said:

> "The Interstate Commerce Commission has its accounting rules with reference to depreciation charges and, pending its order under section 20 (5) of the Interstate Commerce Act, telephone companies, as well as others subject to the Act, have been directed to continue to observe these requirements." (282 U. S. 133, 159.)

There is no intimation of any concealed infirmity in the exercise of this authority by the Interstate Commerce Commission, nor any suggestion that it is not binding on the companies involved.

The application of these accounting rules prescribed by the Interstate Commerce Commission results in the calculation and entry of certain amounts upon the books of the company as the expense of depreciation. The specific rates from which directly this expense is calculated are computed by the accounting company in obedience to these rules, but the rates themselves have not been fixed by the federal commission. As matters stood when *Smith v. Illinois Bell Telephone Co.* was decided these accounting rules did not prevent independent findings as to depreciation in a rate case. Whether subsequent action by the Interstate Commerce Commission as described above in this brief has altered the premises then existing, it is not necessary to consider. This case does not involve the question as to what scope constitutionally belonged to a state commission on April 9, 1934 (the date of this order), in finding the expense of

depreciation as an incident to determining reasonable charges for intrastate service. The contention insisted upon here is that the method of *accounting* for depreciation has been regulated by federal authority; that the validity of this regulation has long since been established; and that in the face of this there is no room for any state regulation of the same subject matter. Certainly the holding of the *Illinois Bell Case* does not stand in the way of this conclusion, because no such question was there involved. And the language of that opinion, so far from suggesting underlying considerations at variance with this result, plainly assumes that the federal authority has dealt with depreciation accounting with the finality and exclusiveness which attends the proper exercise of federal power.

III.

THE ORDER OF THE NEBRASKA STATE RAILWAY COMMISSION, HERE IN QUESTION, IS VOID BECAUSE IT IS IN CONFLICT WITH VALID REGULATIONS OF THE INTERSTATE COMMERCE COMMISSION MADE PURSUANT TO AUTHORITY VESTED IN IT BY CONGRESS.

The constitutional principle which is applicable in this situation is familiar. Article VI, Paragraph 2 of the Constitution of the United States. The position of appellant as stated in the preceding section of this brief, is that the federal authority has completely "occupied the field" to the exclusion of all state action respecting depreciation accounting. We now call in question the validity of this order upon the somewhat narrower ground that it is directly in conflict with the requirements validly imposed by the Interstate Commerce Commission.

The Revised System of Accounts of the Interstate Commerce Commission required the establishment of an account to be known as "608—Depreciation," to which account shall be charged the depreciation expense applicable to the accounting period for various classes of depreciable telephone plant. The instruction with reference to this account required that "the depreciation charges shall be made in accordance with instructions 23-C, 80, 81 and 82." Exhibit 7, p. 70 (R. 214). Instruction 23-C has to do with depreciation on leased telephone plant and is not of interest here. Instruction 82 provides: "The classes of depreciable telephone plant and the accounts covering such plant are as follows:" and then lists twelve different classes of property employed in the telephone business, together with the associated account numbers (R. 213). Instructions 80 and 81 (Exhibit 7, R. 210-213) are here set out for convenient reference:

> "80. Computation and filing of depreciation rates.—(A) The company shall file with the State commission or commissions having jurisdiction, for review and recommendations to this Commission, estimates of the composite annual percentage rates considered applicable to the book cost of each class of depreciable telephone plant owned or used by the company. These percentage rates shall be based upon the estimated service values and service lives developed by a study of the company's history and experience and such engineering and other information as may be available with respect to prospective future conditions. These percentage rates shall be computed in conformity with the group plan of accounting for depreciation and shall be such that the loss in service value of the property, except for losses excluded under the definition of depreciation

(note instruction 3-J), may be distributed under the straight-line method (note instruction 3-Z) during the service life of the property. Such percentage rates shall for each primary account comprised of more than one class of property produce a charge to operating expenses for that account equal to the sum of the amounts that would otherwise be chargeable for each of the various classes of property included in the account. The estimates of the composite annual percentage rates so filed shall be accompanied by a sworn statement showing the bases therefor and the methods employed in their computation. Where no State commission has jurisdiction or is willing to act in the premises, the estimates and the accompanying statement shall be filed with this Commission. A company subject to the provisions of this system of accounts January 1, 1933, shall file such estimates not later than August 1, 1933. A company which becomes subject to the provisions of this system of accounts after January 1, 1933, shall file such estimates within six months after the provisions of this system of accounts become applicable to it. After consideration of the recommendations of the State commission or commissions to the extent available, this Commission will by temporary order prescribe the composite annual percentage rates which shall be charged with respect to each class of depreciable telephone plant. After the issuance of the temporary order, opportunity will be afforded at public hearings, if desired, for the presentation of evidence by all interested parties with a view to the modification of such order and for the submission of views based on such evidence. Such public hearings shall be conducted for this Commission, so far as possible, by State commissions. The company shall be prepared at any time upon direction of this Commission to compute and submit, for its approval, revised percentage rates in cases where existing rates are deemed inapplicable.

"(B) In the event any composite percentage rate prescribed by this Commission, in the judgment of the company becomes no longer currently applicable, the company shall in a like manner file estimates of revised composite annual percentage rates which, in its judgment, should be established.

"(C) The company shall keep such records of property and property retirements as will reflect the service life of property which has been retired, or will permit the determination of service-life indications by mortality, turnover, or other appropriate methods, and also such records as will reflect the percentage of salvage value, or net salvage value, as appropriate, for property retired from each class of depreciable telephone plant.

"81. Depreciation charges.—(A) Charges for currently accruing depreciation shall be made monthly to account 608, 'Depreciation,' and account 702, 'Vehicle and other work equipment expense,' as appropriate, and corresponding credits shall be made to account 171, 'Depreciation reserve.' In computing the current monthly charges, one-twelfth of the composite annual percentage rate applicable to the primary accounts covering depreciable telephone plant shall be applied to the average of the balances, as of the first and last of the current month, in each such primary account.

"(B) In addition, when the company is responsible under the terms of a lease for depreciation of property, used but not owned, for which the rent is chargeable to account 303, 'Rent for lease of operating property' depreciation charges shall be made on the same basis as for owned depreciable property.

"(C) A separate composite annual percentage rate for each account covering depreciable telephone plant shall be used in computing depreciation charges. Such composite rates shall be those which are from time to time prescribed by this Commission, except

that where no rates previously have been prescribed for the company's use by this Commission, the company's estimates of composite annual percentage rates computed in accordance with instruction 80 shall be used prior to the date rates prescribed by this Commission become effective."

In the course of the proceedings of the Interstate Commerce Commission carried on for the purpose of complying with the requirement of the amendment of 1920 directing the Commission to prescribe rates of depreciation, supra, p. 21, it developed and established certain rules and principles for the calculation of depreciation expense. These rules and principles were set out in the report and order of the Commission in the depreciation proceedings referred to above, supra, pp. 21-22, and are embraced in the instructions found in the Revised System of Accounts which we have quoted. These, of course, have been adopted and made fully effective. At the times with which we are concerned they governed the accounting of companies subject to the system of accounts.

An examination of these principles, in accordance with which the companies are required to compute the depreciation charges to be entered upon their books, discloses certain rules which must govern such accounting. Among these requirements is that which compels the adoption of the straight-line system of depreciation accounting, by which the loss of service value of the property is spread evenly during the several accounting periods throughout the service life of the property. These instructions also require that a percentage rate be derived in accordance with this method for each of the several classes of depreciable property prescribed by the

Commission, and that this percentage be applied in the calculation of the expense of depreciation. These instructions, furthermore, directed the companies to derive appropriate percentage rates by ascertaining from a study of the company's past experience and by the use of the best information available as to future conditions the estimated service values and service lives of the several classes of property. This system of depreciation accounting is a coherent, well understood method of deriving the charges to be made upon the books of the company on account of the expense of depreciation. It is not necessary in this connection to defend it or consider its usefulness as compared with any other system of accounting for depreciation expense. It is important only to understand what it is and to point out that it is the system which appellant was required to employ.

1.

Accounting separately by classes of plant.

The Nebraska order requires that a percentage rate of 3½% be applied to all the depreciable property of the appellant in the State of Nebraska. This is to be set over against the requirement of the Interstate Commerce Commission that the company shall calculate in the method there set out a separate rate of depreciation for each of twelve different classes of telephone plant.

> "A separate composite annual percentage rate for each account covering depreciable telephone plant shall be used in computing depreciation charges." Instruction 81 (C), Exhibit 7.

The record shows that the rates of depreciation for various classes of plant vary widely as between these several classes (R. 10). It is in this regard plainly impossible to comply with both the Nebraska order and the Uniform System of Accounts. If rates are derived for each of the classes of depreciable plant by the methods directed to be used by the Interstate Commerce Commission, it plainly will be nothing except a sheer coincidence if a composite result respecting all the property of the company in the state should happen to be 3½%. Nor is there any conceivable way in which an arbitrary percentage, called a composite rate of 3½%, can be broken up into twelve components. Any such process, of course, does not produce "components," but is nothing but a process of division without any principle available to determine the process.

It may be helpful in avoiding confusion at this point if there is a clear understanding as to the proper use of the term "composite" in connection with depreciation rates. Instruction 80 of the Uniform System of Accounts, quoted above, provides:

> "Such percentage rates shall for each primary account comprised of more than one class of property produce a charge to operating expenses for that account equal to the sum of the amounts that would otherwise be chargeable for each of the various classes of property included in the account." (R. 211.)

These percentage rates for any primary account are properly to be called "composite" rates, and the term is so used in the System of Accounts. As an example, selected for its simplicity, Primary Account No. 244 covers underground conduit. This embraces two classes

of property with differing service life characteristics, namely main and subsidiary underground conduit. This is shown, together with the computation of a composite rate for the account, in the following tabulation taken from Exhibit 1 (R. 16):

NORTHWESTERN BELL TELEPHONE COMPANY
COMPUTATION OF COMPOSITE RATES FOR PRIMARY ACCOUNTS
AS OF JANUARY 1, 1934

Primary Account No. 244 UNDERGROUND CONDUIT

Kind of Property	Ledger Value (Amount)	Service Life (Years)	Net Salvage Value (%)	Annual Percentage Rates	Estimated Annual Depreciation Charge (Amount)
(1)	(2)	(3)	(4)	(5)	(6)
Main	$5,077,419	60	0	1.7	$ 86,316
Subsidiary .	1,275.357	30	0	3.3	42,086
Totals	$6,352,776	xx	xx	xx	$128,402

Total investment included in account	$6,352,776
Estimated annual depreciation charge	128,402
Annual composite rate or percentage of depreciation applicable to total of primary account (determined by dividing the total of column (6) by the total of column (2))	2.0%

On the other hand, when the Nebraska Commission orders the use of a "composite" rate of 3½% upon all depreciable property in the state, an entirely different thing is involved. Compliance with that order requires the actual application in accounting of a rate of 3½% to all depreciable property. Even if it had been intended that this rate be broken into rates for each primary account, there is no way in which this can be done except upon a purely arbitrary basis. The Nebraska Commission has used terminology which sounds as if it were intended to take account of the requirements of the Uniform System; in fact, the requirements sought to be imposed by these respective authorities are in direct conflict with one another.

The purpose of the Interstate Commerce Commission in requiring separate rates to be used for each of the classes of plant is apparent. It was not merely to make elaborate a process which might equally well be simple. In the first place it was carrying out the requirement of the statute. (Sec. 20 (5), Interstate Commerce Act, supra p. 21). Pursuant to the statute it had determined the classes of plant as to which depreciation should be accounted for. This having been accomplished, it naturally and properly followed that the accounting companies should be required to account separately for the expense of depreciation with respect to each of these classes of plant. Independently of this consideration, it is clear that the power to prescribe a uniform accounting system must include the power to require that depreciation expense be recorded separately for specified classes of property. Whatever the purpose, it cannot be doubted that it was well within the power of the Interstate Commerce Commission to prescribe this method of accounting, and the fact that it has done so is after all the only thing concerned in this connection.

2.

Straight-line depreciation accounting.

Instruction 80 (A) of the Uniform System of Accounts, First Revised Issue, Exhibit 7, provides that the percentage rates to be used shall be computed in conformity with the group plan of accounting for depreciation, "and shall be such that the loss in service value of the property • • • may be distributed under the straight-line method (note instruction 3-Z) during the

service life of the property." Instruction 3-Z, Exhibit 7, p. 5, is as follows:

> "(Z) 'Straight-line method,' as applied to depreciation accounting, means the plan under which the service value of property is charged to operating expenses and to clearing accounts and credited to the depreciation reserve through equal annual charges as nearly as may be during its service life." (R. 208.)

"Service life" and "service value" will be found defined in Instructions 3-X and 3-Y of the Uniform System of Accounts, Exhibit 7, p. 5. (R. 207.)

As a result of these requirements the system of accounting for depreciation expense is required to embrace the element of ascertaining and spreading in equal instalments throughout the service life of the property in question the total amount to be charged to depreciation expense on account of such item or group of items during its life. It is plain that this procedure once adopted must be faithfully adhered to. It is an express disavowal of this principle if it is at any time departed from, in that the essential feature of it calls for a continuous and consistent method of calculating and recording depreciation during the entire period under consideration. This does not mean that estimates previously made should not be revised if they are discovered in the light of later or fuller information or by reason of changed conditions to be inaccurate. It does mean, however, that when service life and service value have been determined upon in accordance with the best and most reliable information available, there shall be no departure at any point from the objective of spreading this sum representing the serv-

ice value evenly over the period determined to be the service life.

It is apparent that this principle is in danger of destruction if the accounting company, for whatever reason or at whatever behest, may be permitted or required for any period of time to enter amounts as depreciation expense which are other than the instalments calculated for the accounting period involved. There are other methods than the straight-line system of accounting for the expense of depreciation. It is unnecessary in this case to consider their comparative merits. What is now sought to be emphasized is that the straight-line method cannot be employed for a period, abandoned, and then resumed. When this sort of thing happens, it will necessarily result that the straight-line method, by its own definition, has not been employed at all.

This is necessarily true whether the departure from the straight-line method is voluntarily undertaken or whether it is required by some governmental authority. The Interstate Commerce Commission in its System of Accounts has prescribed this method. This being so, there can be no doubt that the authority of the federal Commission to prescribe a Uniform System of Accounts has been permitted to be attacked in a quite inadmissible manner if a state commission has the power to require accounting companies to enter as the expense of depreciation something other than the amount represented by the employment of the straight-line method of accounting.

The Nebraska order in the plainest fashion does just that. It prescribes a fixed rate for the year 1934. The straight-line method of accounting does not permit any

one to prescribe the rate for any year except as a result of the determination that such a rate will represent the proper charges for that year upon the principle of distributing the depreciation expense during the service life of the property in equal periodical charges. The report, findings and order of the Nebraska Commission clearly disclose that it has made no such determination and has on the contrary repudiated the necessity or propriety of it. The Commission, in its second finding which purports to support the order here in question, found;

> "That the factor of inadequacy arising from growth will not be as important a factor in 1934 as it has been in the past, and that respondent's proposed rate of 4.48 per cent will not be required for 1934." (R. 30.)

Under the straight-line method of depreciation accounting such a finding has no more pertinency with respect to the amount to be charged as depreciation expense in 1934 than it has during any other year of the service life of the property being the subject of depreciation accounting. An examination of the report of the Nebraska Commission makes it entirely plain that what the Commission was undertaking was not to require the accounting for depreciation upon the straight-line basis or any other basis of depreciation accounting, but on the contrary was undertaking to express in a percentage actual retirements during the current year and to bring about the charge to expense of the amount of such retirements. Of course, this is retirement accounting rather than depreciation accounting. It may be conceded, for the purpose of argument, that this is one possible way of recording the expense of property used up in

service. It is not necessary to consider whether any obstacles exist in the way of a valid requirement that this method of accounting be used by a public utility. What we are here concerned to say is that of all possible methods of dealing with this expense this method represents as extreme a departure from the requirements of the principle of straight-line depreciation accounting as any that could be contrived.

Moreover, the Nebraska Commission itself has been entirely explicit in its recognition that the order here in question is inconsistent with straight-line depreciation accounting. Its finding quoted in the preceding paragraph discloses this. Reference may also be made to a later decision of the Commission rendered November 27, 1935, purporting to fix a depreciation rate for appellant to apply for 1935. In its opinion in support of such order the Nebraska Commission referred to recommendations which it had made to the Federal Communications Commission, successor to the Interstate Commerce Commission, respecting appellant's depreciation rate, recommending an over-all composite annual depreciation rate of 3.18%, and as to this it said:

> "This was based upon company's retirements for 1933. Our purpose was to prevent a further increase of balance in account for accrued depreciation. We recognized then that we were not following the straight-line method of depreciation accounting, but the line had already been broken by the economic depression; inadequacy had ceased to be a factor in current operation. We now hold that the experience of a single year does not form a sound basis for estimating future depreciation rates." *In the Matter of Depreciation Charges for Class "A"*

and Class "B" Telephone Companies, ... P. U. R. (N. S.) .....

3.

Rates to be based on estimated service values and service lives.

Instruction 80 of the Uniform System of Accounts, referred to above, supra page 44, provides with respect to the depreciation rates to be applied to the several classes of depreciable property as follows:

> "These percentage rates shall be based upon the estimated service values and service lives developed by a study of the company's history and experience and such engineering and other information as may be available with respect to prospective future conditions."

The process of depreciation accounting prescribed by the Interstate Commerce Commission as indicated in the instructions in the Uniform System of Accounts, and as elaborated in the report in the proceeding entitled *Depreciation Charges of Telephone Companies,* Docket No. 14700, 177 I. C. C. 351, is based upon the determination by processes of calculation and estimate of the service life and service value of the particular property under consideration. With these two factors established, an annual percentage rate may be directly derived which is appropriate to be used under straight-line depreciation accounting in calculating the dollars of depreciation expense to be charged to the annual accounting period which is involved.

The order in suit of the Nebraska Commission obviously proceeds in complete disregard of this system of accounting. It prescribes an annual rate of deprecia-

tion, which it is entirely clear from the opinion which accompanied the order (R. 19, 27-28), is not produced by any process of estimating or determining service life or salvage value of the property. This opinion discloses that in so far as the determination of the depreciation of 3½% had any basis at all, it was based primarily upon consideration of the balance in the appellant's depreciation reserve account (R. p. 27). The Commission reaches certain conclusions or makes certain assumptions to the general effect that this balance is too great, and says that its purpose is "to reduce the annual depreciation rate so it will gradually bring the accrued depreciation and the depreciation reserve into a fair relationship" (R. 27). Obviously, this is not deriving percentage rates based upon the estimated service values and service lives of the property as required by the System of Accounts of the Interstate Commerce Commission.

Summarizing: The opinion and order of April 9, 1934 of the Nebraska Commission not only fail to show that the Commission took any account whatever of the requirements of the Federal System of accounts as to the calculation of depreciation expense; they not only disclose plainly that the order appealed from was made with complete indifference to the Federal requirements and with the intention of creating a situation which would make it necessary for appellant to disobey one set of instructions or the other; but they also show clearly that this conflict is inherent not only in the results of the two systems of requirements when placed in application, but in the basic underlying theory upon which they are founded.

Appellant, if it should undertake to obey the commands of both Commissions would have two records of depreciation expense, both of which cannot be true records, because they are different. Therefore it would have no record, in any proper accounting sense, because neither would purport to the exclusion of the other to be the company's record of this expense. This order is to be understood as we have dealt with it, as an attempt to override federal requirements and to place those of the state commission in their place.

IV.

THE ORDER DENIES TO APPELLANT DUE PROCESS OF LAW BECAUSE IT IS NOT FOUNDED UPON ANY EVIDENCE IN THE RECORD AND BECAUSE IT REQUIRES THE MAKING OF INCORRECT ACCOUNTING ENTRIES.

We have directed attention to the infirmities in this order which proceed from its conflict with federal authority. Independently of this, the order is a denial of due process under the Fourteenth Amendment because the record furnishes no basis for such an order.

An order of an administrative board such as the Nebraska Commission is void if made without evidence, or if based upon a finding made upon evidence which clearly does not support it.

Northern Pacific Railway Co. v. Department of Public Works, 268 U. S. 39, 44-45;

Great Northern Railway Co. v. Minnesota, 238 U. S. 340, 345;

Seaboard Air Line v. Georgia Railroad Commission, 240 U. S. 324, 327.

A.

The Order, if enforced, would deprive appellant of the right to keep accurate books of account.

The expense which a telephone company encounters by reason of the using up of its property in service is a fact. Nothing which a company can do in its accounting and nothing which public authority can do in regulating its accounting can change this fact of depreciation expense. Under the method of accounting by which this expense is recorded during the period in which the property is being used, the amount to be charged annually "is the subject of estimate and computation." *Lindheimer v. Illinois Bell Telephone Co.*, 292 U. S. 151, 167.

Apart from conflict with federal authority, it may be conceded that public regulation of accounting may properly deal with various methods and principles to be selected to govern this process of estimate and computation. This order is objectionable because it directs the use of a depreciation rate which will produce an annual charge to depreciation which is in fact and is found by the Commission to be less than the true annual charge for depreciation expense.

This is entirely clear from the opinion which is a part of the order here being reviewed. There is no evidence in this record and no finding of the Commission justifying or suggesting the conclusion that the service lives and service values of property submitted by appellant are not sound and accurate. Where the judgment of Company engineers is a factor, the Commission has not substituted its judgment. There is no room to con-

clude that the evidence introduced by the Commission, such as Exhibits 5 and 6 (R. 197-200), had not been fully taken into account by the appellant in its calculations.

The Commission makes a finding that the factor of inadequacy will not be as important a factor in shortening the life of telephone property in 1934 as it had been in the past, and therefore the depreciation rates proposed by respondent would not be required for 1934 (R. 30). Here again there is no basis whatever for any suggestion that appellant's engineers had not given full consideration to whatever bearing this fact might have upon depreciation rates. In fact, the composite of the rates filed by appellant was lower than it had ever been before, and had been declining for several years (R. 192). Moreover, the record discloses that population growth in the territory served by the appellant has been gradual and that generally in this territory the retirement of telephone property has not been influenced to any large degree at any time by a spectacular growth in population (R. 58). Thus it is clear that the two exhibits introduced on behalf of the Commission do not themselves furnish any basis at all for the order which the Commission made respecting depreciation accounting, nor does such evidence impair the force of the data which appellant was permitted or required to submit in support of the rates which it proposed using.

B.

The Order is intended to and does require the use by appellant in its accounts of a depreciation rate which was less than the true rate for the sole purpose of reducing the balance in its depreciation reserve account.

It is necessary to search elsewhere to find the real basis for the Commission's order. This is amply disclosed by the opinion which accompanied the order appealed from. There the Commission points to certain figures indicating the percentage of the depreciation reserve account balance to the total of investment in plant and equipment, which at the end of 1932 was 24.24 per cent. It may be noted that generally this percentage had been declining over a period of years (R. 192). The Commission then points to Exhibit 4, which was a copy of a summarized estimate of the valuation of a portion of the property of appellant in the State of Nebraska presented by appellant to the Commission in a proceeding during 1933 (R. 195-196). In this exhibit appellant's valuation engineer had estimated the condition per cent of the property as 88 per cent of condition new. The testimony shows that this estimate undertook simply to take account of the operation of such factors tending to decrease the value of the property as had already manifested themselves in the property at the time of the engineering inspection and did not take account of factors whose effects upon the property lay wholly in the future (R. 80-81).

Under the regulations governing the calculation of depreciation charges prescribed by the Interstate Commerce Commission it is necessary to take account of

very important factors causing the ultimate retirement of property, the effect of which cannot be discovered upon an inspection, for the simple reason that such factors have not, up to the time of the inspection, produced any effect upon the property. For instance, the destruction of property by storms, fire and other similar casualties is a substantial factor in terminating the service life of telephone property (R. 85, 172-173). Accurately calculated depreciation rates must take account of these factors. However, an inspection of the property for the purpose of determining its condition will not discover anything affecting the property attributable to casualties which have not yet occurred. A similar observation may be made with respect to retirements occasioned by invention and by public requirements, such as the necessity of removing pole lines in connection with highway changes, replacing overhead plant by underground construction and the like. Many of these causes of retirement are very important, and many of them operate suddenly, without substantial previous warning and without previous effect upon the condition of the property (R. 165).

Rates of depreciation must provide for retirement from all causes. The depreciation reserve balance represents the provision so far made for the retitrement of the present property from any and all causes which are factors in depreciation. Of course the percentage relationship of this balance to the investment in depreciable property will be different from the so-called condition per cent observed upon an inspection of the property at a given time.

The Commission, after noting these two percentage relationships, expresses its concern that what it refers

to as accrued depreciation is thus indicated to be 12 per cent, whereas the balance in the depreciation reserve account is 24 per cent. This report then proceeds to deal with the matter in the following language:

> "In ascertaining the amount required for annual depreciation it is first necessary to determine the service life of the several units of depreciable property. The factors determining service life are decay, wear and tear, physical deterioration, current action of the elements, obsolescence, inadequacy, demands of public authority and such other factors that are not restored by current maintenance. In determining accrued depreciation or percentage condition for ascertaining the fair value for rate making purposes, valuation engineers make inspection of the property to determine observed deterioration and do not give full consideration to the factors which determine the service life of the several units of property. We hold that the same factors should be considered by valuation engineers that are considered by the plant engineers and accountants in determining the required amount of annual depreciation. The differential of the respondent's actual depreciation and its depreciation reserve is probably due to this situation. The instant case presents a situation where it is the duty of the Commission to reduce the annual depreciation rate so it will gradually bring the accrued depreciation and the depreciation reserve into a fair relationship." (R. 27.)

We do not pause to do more than refer in passing to the failure of the premises in this statement to sustain the conclusion. The comment of the Commission is all in the direction of suggesting that the method of estimating service lives and service values for the purpose of depreciation expense accounting is sound and that the ascertainment of accrued depreciation for the pur-

pose of its deduction in valuation ought to conform to the same principles. The conclusion then is that the Commission should order a change in methods of depreciation accounting in order to bring this into conformity with the method of conditioning property for valuation purposes which the Commission has just found to be improper.

The disparity between the percentage of balance in the depreciation reserve account and the percentage of accrued depreciation which engineers find upon inspecting the property, was fully explained in the record (R. 80-82). Whatever bearing the matters which the Commission discusses in its report may have upon the consideration of the problem of ascertaining value in a rate case, it is clear that in the particular matter with which we are now dealing the premises found by the Commission to exist cannot in accordance with any process of orderly reasoning be brought to support the conclusion at which it arrives and upon which its order is based.

However, the exposure to view of this process of reasoning shows clearly what the Commission was seeking to do. It was undertaking to require lessened charges to be made to depreciation expense, and therefore smaller credits to the depreciation reserve account, in order to reduce the ratio which the balance in this account bears to investment in plant and equipment. The depreciation reserve account is simply an incident of the system of bookkeeping required to be employed under the Uniform System of Accounts. To this account are credited the amounts currently debited to the depreciation expense

account. When property upon which depreciation has been charged is retired, the cost of such property, less salvage, is credited to the proper plant account and debited to the depreciation reserve account. It is the balance in this depreciation reserve account with which the Commission is preoccupied, and which it seeks to reduce for the purposes above indicated.

Now it must be clear that this result can be accomplished only by requiring that the credits to this account for the future shall be less than the true periodical amounts of depreciation expense. We submit that no regulatory commission can validly for any such purpose, or for any purpose, require a company subject to its jurisdiction to record as depreciation expense amounts which are known to and intended by the Commission to be inadequate.

If it were true that the balance in the depreciation reserve account was larger than it should have been under proper depreciation accounting, this would necessarily be the result of crediting to the depreciation reserve account amounts which should have been credited to surplus. We do not understand that this court has ever given its approval to any contention that charges in current accounting for depreciation should be either more or less than the true amounts of such expense. Compare *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U. S. 23, 30-32; *Knoxville v. Knoxville Water Co.*, 212 U. S. 1, 13-14. Whatever may have been the course of things in the past, it must be both the right and the duty of the company as respects its current accounting to keep correct rather than incorrect records of the transactions being accounted for.

In fact, the record in this case furnishes no basis whatever for the view that the balance in the depreciation reserve account was not entirely proper and the inevitable result of proper accounting. The record shows that what the relationship ought to be between the amount of this balance and the total investment in depreciable property depends upon the age distribution of the property, and no intelligent view can be had as to this matter without elaborate studies (R. 57-58). At the time of the making of the order here in question, the Interstate Commerce Commission had required the making of such a study, and it was in process of being carried forward at the time of the hearing (R. 57). The evidence also disclosed that if proper depreciation charges are made, taking account of the situation of appellant's property at the time of the hearing, it would be inevitable that the ratio of the balance in the depreciation reserve account to investment would increase from that time forward for a considerable period (R. 184). This is because the appellant has a relatively large recent investment in buildings, conduit, dial central office equipment and toll terminal equipment. Retirements from this class of property have been small up to this time and will continue to be relatively limited for a considerable period (R. 182-183). Depreciation is charged upon the investment in this class of property in the meantime, and is credited to the depreciation reserve account. It is apparent that it must be so charged if there is to be a

balance in the account against which it may be charged upon ultimate retirement. Consequently, this characteristic of the appellant's situation is such as to cause the reserve balance to increase over a substantial period of time, and appellant's engineer pointed out that this must be expected (R. 183).

If the principle of straight-line depreciation accounting is admitted, the only relevant factors are the estimated service life of the property and its service value, i. e., its cost less net salvage. If these are known or reliably estimated the annual depreciation rate is a simple calculation. Appellant's depreciation rates are computed upon the basis of such engineering intelligence and judgment as it is possible for appellant to bring to bear on this problem. We submit that there is nothing in this record to furnish any basis for doubting their soundness. Of course, they deal with the future, and it is not pretended that events as they happen may not call for re-examination. In fact, such re-examination is constantly being made. Upon the premises indicated, however, we respectfully urge that carefully calculated and estimated rates of depreciation are not to be disturbed upon the basis of considerations having no more relation to the subject of inquiry than those which are expounded by the Nebraska Commission in the order and opinion involved in this appeal.

CONCLUSION

Upon each and all of the grounds above set forth, it is respectfully urged that the judgment of the Supreme Court of Nebraska should be reversed.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 350

NORTHWESTERN BELL TELEPHONE COMPANY,
Appellant,

vs.

NEBRASKA STATE RAILWAY COMMISSION,
Appellee.

APPEAL FROM THE SUPREME COURT OF THE STATE OF NEBRASKA

BRIEF IN ANSWER TO BRIEF OF NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS

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COCKLE PRINTING CO., LAW BRIEFS, OMAHA

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BRIEF IN ANSWER TO BRIEF OF NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS

THE FEDERAL GOVERNMENT HAS POWER TO REGULATE AND HAS REGULATED THE ACCOUNTING OF APPELLANT TO THE EXCLUSION OF ANY STATE REGULATION THEREOF.

The first point sought to be made on behalf of the National Association is:

> "Reports of public service companies to state governments, and accounts prescribed by state law to enable such reports to be made, are means and instrumentalities of state government not subject to destruction by Congress."

If we correctly understand this contention, it is that the bookkeeping of carriers engaged in interstate commerce is a "means and instrumentality" of state government, and no federal regulation thereof is valid if in-

consistent with the requirements of state law. This statement seems at once to be so far in conflict with principles which are not open to question as to suggest re-examination to the end of being certain that it is properly understood.

Interstate carriers, like all other substantial enterprises, must keep books of account. The manifold activities of government make such accounting records of obvious public concern in many respects. No doubt, such accounts are of concern to both state and federal authority. No elaboration is required to establish this as respects a common carrier, organized under state law, engaged in both interstate and intrastate commerce and owning property in various states.

It must be noticed that the attack upon the order in suit is with reference to what it requires of appellant as to its *accounts,* and not what it requires as to its *reports* to the Nebraska Commission. This very proceeding before that body is sufficient to illustrate the readiness of appellant to furnish information in its possession to the appellee. There has never been any question of the right of the state commission to require appellant to report to it what its depreciation expense would amount to if figured at 3½ per cent upon all its property in the state, or upon any other basis.

Of course, any regulation of accounting which represents anything more than the shadow of authority will direct what accounting records are to be kept and how they shall be kept. It is as much concerned with forbidding as it is with directing. The normal objective is that the accounting company shall have a set of bookkeep-

ing records and that it shall be that prescribed, not that it shall have the prescribed record and also several other and different records of the same transactions. We have pointed out that the purpose of Congress in Section 20 of the Interstate Commerce Act to conform to this principle is clearly disclosed by authorizing the Interstate Commerce Commission to require the use of "a uniform system of accounts," to "prescribe the forms of any and all accounts, records, and memoranda," and by forbidding the keeping of any other accounts than those prescribed.

Reference is made by the Association in its brief, p. 9, to the requirements of the Federal Power Act. This would seem principally to serve the purpose of emphasizing the difference between what is there quoted and the provisions of the Interstate Commerce Act above referred to.

The reference in the same place to Section 220 of the Communications Act of 1934, so far from showing that "the powers of state commissions with respect to accounting have not been terminated," very clearly shows the intent of that act to continue in the new agency the same authority over the accounting of communications carriers formerly vested in the Interstate Commerce Commission.

There can be no doubt that Congress has authorized the federal Commission to prescribe the accounting of carriers subject to the Interstate Commerce Act. Congress intended that when such a system of accounting was prescribed, it, and no other, should be followed. The statute so provides. This Court upheld the statute and action taken under it in *Interstate Commerce Com-*

mission v. Goodrich Transit Co., 224 U. S. 194. Under our constitutional system this valid exercise of federal authority under the commerce clause has the effect which may flow from it both upon the carriers affected and upon the several state governments. This is because in case of conflict federal and not state rule is the supreme law of the land. The brief of the Association seems to rest upon the premise that exercise of federal authority under the commerce clause, otherwise valid, must yield to state authority to the extent it may conflict therewith. It is hardly necessary to say that the law is to the contrary.

It does not appear to be the argument of the Association that the state has power to regulate the accounting for intrastate business and the federal government has power over that for interstate business. Aside from the fact that in the telephone business the interstate and intrastate operations are inseparable, so that two sets of accounts become a practical impossibility, that constitutional question was disposed of in *Interstate Commerce Commission v. Goodrich Transit Co.*, supra. The argument here is that both governments have power to regulate the accounting for both types of business. See Association's brief, p. 31. That contention must at once be rejected, the federal authority having been exercised. The conflict inevitably attending any such anomalous program is noticed by the Association in the last recital of the resolution adopted by it and quoted on page 11 of its brief:

> "It is highly desirable that accounting regulations prescribed for the use of companies subject to the jurisdiction of both Federal and State authorities

> shall be prepared in cooperative conferences and shall be prescribed by both Federal and State authorities whenever that shall be possible, so that conflicting and diverse requirements may be avoided;"

What the Association and its counsel obscure is the principle that under our system there can be no such thing as conflicting requirements validly imposed by the state and federal governments.

THE JURISDICTION OF THE NEBRASKA COMMISSION TO MAKE THE ORDER IN QUESTION HAS BEEN DESTROYED BY THE EXERCISE OF PARAMOUNT FEDERAL AUTHORITY.

The proposition representing the contrary of the heading of this section of the brief constitutes the point to which most of the remainder of the Association's brief is directed. The argument of counsel for the Association to the effect that there has been no valid federal regulation of depreciation accounting requires for its completeness a premise which is left unstated by counsel. This premise is that the Interstate Commerce Commission had no authority over the depreciation accounting of telephone companies except as it was to be found in the amendment to Section 20, Paragraph 5 of the Interstate Commerce Act, which was made by the Transportation Act of 1920. See appellant's brief, p. 21. This amendment directed the Commission to prescribe the depreciation rates to be used by carriers in their accounting. It is argued that the Commission has not yet prescribed such rates, and therefore has exercised no lawful authority over depreciation accounting.

The difficulty of supplying this premise for the Association's argument is that it is wholly without foundation. The Interstate Commerce Commission long before the 1920 amendment had been clothed with authority to regulate the accounting of carriers subject to the Act. This included the authority to regulate depreciation accounting as fully as it included the authority to regulate the accounting for any other fact or transaction. The amendment of 1920 made it mandatory upon the Commission to prescribe the actual depreciation rates to be used in accounting. The Commission has never prescribed these rates, and except for the fact that the amendment requires it to establish classes of depreciable property, which has been done, we are not further concerned with the effect of this amendment in this case.

What the Interstate Commerce Commission has done, with respect to its presently applicable directions to carriers as to depreciation accounting, was done pursuant to the authority of the Interstate Commerce Act giving it power to prescribe a uniform system of accounts for telephone companies. It did not rest upon the authority of the amendment to Section 20, Paragraph 5, above referred to. As was necessary in order to establish a complete system, it prescribed the methods and principles which form the requirements of the system respecting the accounting for depreciation.

The Association characterizes this portion of the system of accounts as a "short cut" method of prescribing depreciation rates pursuant to the 1920 amendment. It is very apparent that it was nothing of the kind. The requirements of the system of accounts promulgated for

use on and after January 1, 1933, to which counsel for the Association takes exception, are not essentially different from the requirements which have been imposed on telephone companies ever since the Interstate Commerce Commission first prescribed a system of accounting for telephone companies effective January 1, 1913.* It will not do to become so far preoccupied with the activities of and proceedings had by the Interstate Commerce Commission in its endeavor to fix rates of depreciation pursuant to the amendment of 1920 as to lose sight of the complete authority to regulate depreciation accounting which long before that had been vested in and exercised by the Commission. It simply continued to exercise an authority over the depreciation accounting of telephone companies which it had possessed ever since they became subject to the Interstate Commerce Act.

We have already dealt in the appellant's brief with the considerations which we confidently urge as supporting the position that (a) the Federal Government has occupied the field of regulation of the accounting of carriers subject to the Interstate Commerce Act, and all state regulation of accounting is thereby precluded; and (b) independently of this, the requirements of the system

* The Uniform System of Accounts for Telephone Companies, First Issue, effective January 1, 1913, p. 67, provided:

"Telephone companies should include in operating expenses depreciation charges for the purpose of creating proper and adequate reserves to cover the expenses of depreciation currently accruing in the tangible fixed capital. * * *

"The amount charged as expense of depreciation should be based upon rules determined by the accounting company. Such rules may be derived from a consideration of the company's history and experience. Companies should be prepared to furnish the Commission, upon demand, the rules and a sworn statement of the facts, expert opinions, and estimates upon which they are based. * * *

"The rate of depreciation should be fixed so as to distribute, as nearly as may be, evenly throughout the life of the depreciating property the burden of repairs and the cost of capital consumed in operations during a given month or year, and should be based upon the average life of the units comprised in the respective classes of property."

of accounts as respects depreciation accounting make it impossible to comply with the order in question because they are in conflict with one another. It is not contended by the Association's counsel, as we understand it, that it is possible for appellant to obey a requirement of the system of accounts that it derive rates of depreciation according to the methods there prescribed and use them in its accounting, and at the same time obey the order of the Nebraska Commission. Of course, this is impossible.

What is argued on behalf of the Association is that the requirements of the system of accounts are ineffective because they leave it to the companies to make the estimates and calculations upon which the depreciation rates are to be based. We have already suggested the error which underlies the essential basis for this argument. It is the assumption that the direction to the companies contained in the system of accounts to estimate the service lives and salvage values upon which the rates depend is pursuant to the legislative direction to the Commission itself to prescribe depreciation rates. We have shown that this is not the basis of the directions in the system of accounts. Rather, such directions depend upon the authority given the Commission to regulate accounting. Of course, there is nothing novel in a system of accounts established by public authority which directs certain entries upon the books to be based upon calculations or estimates made by the accounting company. It is common knowledge that certain accounting entries must be founded upon a greater or less degree of estimate. The system of accounts, Exhibit 7 in this Record, contains a large number of instances independently of the regulations pertaining to depreciation accounting, where the

accounting company is directed to make entries based upon its estimates of one kind and another.*

Similar considerations seem to underlie the attempted distinction suggested on p. 32 of the Association's brief between prescribing the "rate of depreciation" and prescribing "the form of depreciation." Presumably counsel mean the form of depreciation accounting or of depreciation accounts. No such distinction in this connection is admissible. It may be repeated at this point that the whole concern with the matter of depreciation as we encounter it here is solely a matter of depreciation accounting. Whether the state governments or whether the Federal Government has power to determine or prescribe or establish rates of depreciation for any other purpose than directing that they be used in making accounting entries is a matter completely without interest in this case. The Interstate Commerce Commission did not establish rates of depreciation. It continued to do what it had done from the beginning of its exercise of authority over the accounting of telephone companies, and established the principles in accordance with which the expense of depreciation was to be calculated and esti-

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* Only the portions of the system of accounts relating to depreciation accounting are printed as part of the Record in this Court. The following references, among many others, to the system of accounts, Exhibit 7, illustrate the recognition throughout the system of accounts of the propriety of directing entries to be based upon estimates of the accounting company:

Instruction 20 (B). Property acquired for a consideration other than money to be entered in the appropriate plant account at a money value to be determined by the company.

Instruction 21 (B) (2). When telephone plant is purchased there is to be charged to the depreciable plant accounts "the current cost new (estimated if not known), of the property classable therein."

Instruction 25 (D). When telephone plant is retired, "When the actual book cost cannot be determined from the records, it shall be estimated."

Similar processes of estimation are required in connection with charges and credits on account of an insurance reserve carried by a self insurer and on account of a reserve for uncollectible accounts where such is maintained.

mated, and directed the companies to make such calculations and estimates and enter them upon their books. Whether state commissions may inquire and determine what the amount of depreciation expense of such company is for any purpose other than accounting, it is too plain for argument that it cannot do so for accounting purposes without invading the field which Congress and the Interstate Commerce Commission have occupied.

The distinction asserted between the "form" of depreciation accounting and its substance or content is a spurious one. A similar argument was made and overruled in *Kansas City Southern Ry. Co. v. United States*, 231 U. S. 423, where this Court said at pp. 440-441:

> "As to the intent and meaning of § 20, it is first insisted that the power conferred upon the Commission to prescribe the forms of accounts, records, and memoranda to be kept by the carriers, recognizes a distinction between the form and the substance; and that while the Commission, in order to obtain full and accurate information concerning the affairs of each corporation, must have power to require any reports, schedules, and accounts necessary to show the true financial condition of each carrier; yet that the grant must by fair interpretation, and in order not to amount to an unconstitutional delegation of legislative power, stop short of the point where the regulation in its essence goes not to the form but to the substance and involves interference with the internal affairs of the corporation. We do not, however, think that any such distinction between the form and the substance is admissible with respect to the declared object of standardizing railroad accounts and obtaining therefrom full and accurate information concerning the affairs of the respective corporations. The very object of a system of accounts is to display the pertinent financial operations

> of the company, and throw light upon its present condition. If they are to truly do this, the form must correspond with the substance. In order that accounts may be standardized, it is necessary that the accounts of the several carriers shall be arranged under like headings or titles; and it is obviously essential that charges and credits shall be allocated under the proper headings—the same with one carrier as with another."

The forms of accounts which Congress authorized the Commission to prescribe do not concern their typographical appearance upon the books of the company. They have to do essentially with what a given account shall embrace. As was said in the opinion just quoted from:

> "And since, as just shown, uniformity in accounting is dependent upon the adoption and enforcement of precise classification, the authority to define the terms of the classification necessarily follows." 231 U. S. at p. 443.

Counsel for the Association say, "The making of estimates of depreciation is not accounting" (p. 32 of Association's brief). Where the making of estimates of depreciation is done solely for the purpose of accounting, it is quite clear that the making of such estimates is a step in the process of accounting and nothing else. Where it happens that proper accounting in any field involves the making of estimates, it would seem self-evident that the public body having power to regulate such accounting has power to direct that the estimates be made and to determine in accordance with what principles they shall be made. The regulatory authority does not cease to function as such because it does not undertake to make the estimates itself.

It may be necessary to restate that the only concern with the order in question is with respect to its attempt to control the accounting of appellant. No objection is made to appellee Commission making "estimates of depreciation." So far as the making of such estimates is a process in itself, independent of accounting, we suppose no one would deny the right of either the Commission or the company to make any such estimates as may be of interest to either. Public regulation does not consist in making abstract determinations. It consists of directing the conduct of those subject to regulation.

Here the only effect of the state's authority has been to require the making of certain calculations and the entry of the resulting amounts upon appellant's books. This is the regulation of accounting. We have shown this to be beyond the state's power.

Even if there had somehow been saved to the states the authority to make the estimates of service lives and service values which are the criteria of annual depreciation charges as defined by the federal regulations, the Nebraska Commission has not pretended to make any such estimates.

It must be emphasized that nothing in the argument of appellant here implies lack of power in the state in a proceeding to fix charges for intrastate service to make its own determination of the expense of depreciation. It may be fully assumed for the purpose of this case that such power exists. No such considerations are here involved. The only effect of applying the order in suit would be to release to surplus, available for dividends or investment in plant, amounts now credited to the depreciation re-

serve account. The language quoted from *Lindheimer v. Illinois Bell Telephone Co.*, 292 U. S. 151, 167, on page 20 of the Association's brief, pertinent as there used by the court, is not applicable here. Subscribers are not in effect providing capital contributions unless the charges for service are in excess of just and reasonable charges. The earnings of appellant in Nebraska were at a level which precluded any suggestion that the depreciation expense charged upon appellant's books afforded any basis for undue exactions from its patrons (R. 83-84).

The character of the order as an accounting regulation without relationship to any proceeding for regulating the rates charged for service, was presented to the Commission, and the appreciation of it is evidenced by the following quotation from the dissenting opinion of Commissioner Drake:

> "I agree that if this were a rate case, instead of an accounting question, with the same facts presented, and presented in a properly conducted and concluded case, that I would probably agree as to the rate, but the present proceeding is not a rate case. If the order entered herein is valid, upon the same theories we can then issue an order which would set out the salaries which respondent could enter on its records as expense items for 1934. We do have the authority, in a rate case, to say what are reasonable items of expense for depreciation and for officers' salaries and other expenses, but I seriously doubt any jurisdiction to do so in an accounting investigation." (R. 40.)

THE REQUIREMENTS OF DUE PROCESS FORBID THE MAKING OF THIS ORDER BY THE NEBRASKA COMMISSION WITHOUT PREVIOUS NOTICE OR HEARING.

This question, of course, is not to be disposed of by a characterization of the order as "legislative in character." We regard it as legislative, in the sense that it prescribes a rule for future conduct rather than adjudges rights existing upon the basis of accomplished facts. In the same way an order of a regulatory body fixing charges for service is legislative in character, but we doubt that any one would argue that the Nebraska Commission could fix the rates of public utilities subject to its jurisdiction without notice or hearing, even apart from any statutory requirement in that regard.

The emphasis in our argument upon this question should remain upon the fact that the provision for a judicial review of the order in question is by an appeal and is limited to the record made before the Commission. In this fundamental respect this order differs from orders prescribing accounting which might be made by the Interstate Commerce Commission or other federal agencies referred to in the Association's brief. We are not concerned with the situation where the validity of accounting regulations could be attacked by injunction proceedings or other judicial means, and evidence there introduced by the carrier or other person affected. Compare the provisions of the Urgent Deficiencies Appropriations Act, U. S. C., Title 28, Sections 41 (28), 43-48.

Such cases as *State Corporation Commission v. Wichita Gas Co.*, 290 U. S. 561, are not pertinent in this connection. The appellant's claim that it was entitled to

notice and a full hearing before this order was made effective against it, does not rest alone upon the contention that it interferes unconstitutionally with appellant's property rights. Appellant contends that this order, if enforced, would require it, under the sanctions and penalties of state authority, to keep accounts in a manner forbidden under the sanctions and penalties of federal statutes. It urges that subjection to such oppressive and arbitrary requirements without notice and an opportunity for a full hearing thereon would deprive it of its liberty as well as of its property without due process of law.

Respectfully submitted,

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IN THE

SUPREME COURT

OF THE

UNITED STATES

October Term, 1935

No. 350

NORTHWESTERN BELL TELEPHONE COMPANY,
APPELLANT,

VS.

NEBRASKA STATE RAILWAY COMMISSION,
APPELLEE.

BRIEF OF APPELLEE

WM. H. WRIGHT, Attorney General of Nebraska,
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IN THE

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APPELLEE.

BRIEF OF APPELLEE

WM. H. WRIGHT, Attorney General of Nebraska,
EDWIN VAIL, Assistant Attorney General,
Attorneys for Appellee.
JOHN E. BENTON, *of Counsel.*

STATEMENT

By reason of the fact that the statement of the case made by appellants omits a number of matters which we consider material to the consideration of the questions pre-

sented by the record, and particularly because we believe that appellant has failed properly to construe and interpret the proceedings had by the state commission, we feel impelled to include what we deem to be a complete and accurate statement of the case in this, our own, brief.

Nature of the Case

Appeal by the Northwestern Bell Telephone Company from a decision of the Supreme Court of Nebraska affirming an order of the Nebraska State Railway Commission directing the Northwestern Bell Telephone Company to use a composite depreciation rate of 3½% upon all of its depreciable property in Nebraska, including right of way, for the year 1934 for the purpose of accounting and reporting to the Nebraska State Railway Commission.

SOURCE AND EXTENT OF JURISDICTION OF THE STATE COMMISSION

The jurisdiction of the Nebraska State Railway Commission has its origin in Section 20, Article IV of the Constitution of the State of Nebraska, which provides, amongst other things:

> "The powers and duties of such commission shall include the regulation of rates, service and general control of common carriers as the legislature may provide by law, but in the absence of specific legislation the commission shall exercise the powers and perform the duties enumerated in this provision."

In the absence of specific legislation limiting its power, the Railway Commission, under this section, has all the power in the regulation of rates, service and general control over common carriers that the people themselves could

exercise. *In re Lincoln Traction Company,* 103 Neb. 229; *In re Yellow Cab & Baggage Company,* 126 Neb. 138.

Telephone companies have been held by the Nebraska Supreme Court to be common carriers under the constitutional provision above referred to, and to be subject to regulation by the Commission. *Farmers & Merchants Telephone Co.* v. *Orleans Community Club,* 116 Neb. 633; *Hooper Telephone Co.* v. *Nebraska Telephone Company,* 96 Neb. 245; *Marquis* v. *Polk Co. Telephone Co.,* 100 Neb. 140; *Blackledge* v. *Farmers Independent Telephone Company,* 105 Neb. 713.

The Nebraska State Railway Commission has independent legislative, judicial and executive or administrative powers so far as necessarily involved in the regulation of rates, service and general control of common carriers. *In re Lincoln Traction Company,* 103 Neb. 229.

NATURE OF THE PROCEEDINGS BEFORE THE STATE COMMISSION

On November 29, 1933, the Commission entered its general order No. 59 (R., pp. 2 to 10). This order was made in connection with an opinion or report stating the purpose of the Commission and containing recitals and findings on which the order is based.

This opinion, together with the findings and order, initiated the proceedings which culminated in the legislative order fixing the depreciation rate for 1934 of which complaint is made.

Opinion Discusses accounting Regulations Prescribed by Interstate Commerce Commission to Become Effective January 1, 1935

In its opinion (R., pp. 2-9), the Commission examines the provisions of the Interstate Commerce Act under which the Interstate Commerce Commission undertook to prescribe a uniform system of accounts for telephone companies.

It is pointed out that while the Interstate Commerce Commission had authority to, and did, prescribe a uniform system of accounts for telephone companies as early as January 1, 1913, it was not until the enactment of the Transportation Act of 1920, by which Section 20 of the Interstate Commerce Act was amended, that any power was attempted to be bestowed by Congress upon the Interstate Commerce Commission to fix or prescribe depreciation charges. The Interstate Commerce Commission, after extensive hearings, entered an order prescribing rules and regulations whereby the Interstate Commerce Commission might eventually pass upon and fix and prescribe depreciation charges for telephone companies reporting to it. *Depreciation Charges for Telephone Companies*, Docket No. 14700, 177 I. C. C. 351. The rules and regulations prescribed by the Commission were incorporated in and made a part of the "First Revised Issue" of the Uniform System of Accounts for Telephone Companies, which was issued November 12, 1932, by the Interstate Commerce Commission, and became effective January 1, 1933, as to Class A companies, that is,—those having average annual operating revenue exceeding $100,000.00 (R., p. 204), which included the appellant.

It was provided by the Interstate Commerce Commission, 177 I. C. C. 351, that for the assistance of the Interstate Commerce Commission in prescribing depreciation charges, Class A telephone companies should file with the state commission "having jurisdiction over the particular company" (177 I. C. C. 446) their estimates of the composite annual percentage rates considered applicable to the book cost of each class of depreciable telephone plant owned or used by the company (R., pp. 210-211), together with supporting data.

These estimates and percentages were required to be filed in the first instance not later than September 1, 1932, and the revised rules were to be effective commencing January 1, 1933; however, by subsequent order, Class A companies were required to file their estimates and supporting data with the State Commissions not later than August 1, 1934, and the date as of which depreciation accounting was prescribed became effective January 1, 1935, as to Class A companies (R., p. 4).

Request of Interstate Commerce Commission for Information As to 1934 Rates

For the year 1934, the Interstate Commerce Commission, through its Bureau of Accounts, issued its Depreciation Section Series Circular No. 7, in part as follows:

> "In order that the Commission may be informed as to the rates contemplated for use by the respective companies for the year 1934, each Class A and Class B telephone company is requested to submit not later than March 1, 1934, a schedule of the rates by primary accounts which it proposes to apply during that year, together with a statement of the estimated service lives and salvage values upon which such rates are based.

"In view of the fact that the estimated rates covered by the schedules to be submitted by Class A companies, August 1, 1934, and by Class B companies August 1, 1935, must be accompanied by the necessary supporting data, and it is assumed that the preparation of these is receiving appropriate consideration at this time, the only requirement with respect to the rates submitted in response to this request is that the service lives and salvage values shown shall be based upon the best information readily available. In order words, for the purpose of the returns (fol. 10) to be made under this circular the details supporting the service lives and salvage values used will not be required" (R., p. 5).

General Order No. 59 Relates to Two Subjects

It is, therefore, apparent that as matters stood on November 29, 1933, the date of General Order No. 59, there were two subject-matters before the Nebraska State Railway Commission, which are considered in the said General Order No. 59.

First Subject: Proceedings in cooperation with the I. C. C. under its orders in Docket 14700 to fix 1935 rates of depreciation.

The first subject-matter of the order is the receiving of the estimates and supporting data required to be furnished by telephone companies under the provisions of Instruction 80 of the First Revised Issue of the Uniform System of Accounts for Telephone Companies, prescribed by the Interstate Commerce Commission (R., p. 210). This instruction prescribed that the estimates and data should be filed with the state commissions and their recommendations forwarded to the Interstate Commerce Commission for action

thereon. The effective date for filing the estimates and supporting data, as fixed by the Interstate Commerce Commission, was August 1, 1934, and the same would be applicable to rates which might be fixed when the regulations for depreciation accounting became effective on January 1, 1935 (R., p. 4).

Second Subject: Proceedings by the Nebraska State Railway Commission to fix the 1934 depreciation rates.

There is, however, an additional subject-matter treated of by the order, which had its origin in Depreciation Section Series Circular No. 7 issued by the Interstate Commerce Commission.

This circular requested that schedules of depreciation rates and a statement of the estimated service lives and salvage values upon which the rates were based, be submitted not later than March 1, 1934, "in order that the Commission may be informed as to the rates contemplated for use by the respective companies for the year 1934" (R., p. 5).

The requirements as to estimates differed materially from the requirements imposed under Instruction No. 80 of the First Revised Issue of the Uniform System of Accounts for Telephone Companies in that no supporting data was required.

Again, the recommendations of the state commissions were not asked for.

It is possible that appellant is correct when it states (Brief, p. 5) that it was not intended that these schedules

be filed with the state commissions, and that the state commission erred in so interpreting the circular.

However, be that as it may, there can be no doubt from the order that the state commission regarded the schedules and data requested to be filed March 1, 1934, as having to do, not with the proceeding pending before the Interstate Commerce Commission, for the fixing of rates under the revised accounting rules effective January 1, 1935, but as having to do solely with depreciation charges for the year 1934.

Assuming that the determination of depreciation charges upon property located in Nebraska and used in intrastate operations rested with the state commission (R., p. 8), it required all Class A telephone companies to file with it on or before March 1, 1934, the same data as the Interstate Commerce Commission had requested (R., p. 9).

That the purpose of requiring this filing was as a preliminary step to establishing the 1934 depreciation charges does not admit of any doubt.

Preliminary to its finding and orders with regard to the showing thus required to be filed by Class A telephone companies on or before March 1, 1934, with regard to their depreciation rates for that year, the Commission discussed the question of possible conflicting jurisdiction between the Interstate Commerce Commission and the State Commission (R., p. 6).

It was pointed out that the Interstate Commerce Commission had for many years required telephone companies to furnish annual reports under its Uniform System of Ac-

counting; that the Nebraska State Railway Commission had not attempted to set up an accounting system of its own, but had allowed telephone companies to file with it copies of the reports filed with the Interstate Commerce Commission (R., p. 7).

The opinion recites again the pendency of the proceeding before the Interstate Commerce Commission in Docket No. 14700 to prescribe depreciation charges, and calls attention to the fact that the effective date for filing schedules of percentages and supporting data in that proceeding had been postponed, as to Class A companies, to August 1, 1934 (R., p. 7).

It is then stated:

> "To establish percentage rates for 1934, Circular No. 7 provides that percentage rates and certain available data must be filed with the state commissions on or before March 1, 1934" (R., p. 7).

It may be that, as appellant suggests (Brief, p. 5), the commission erred in interpreting Circular No. 7 to require filing with the state commission. This is immaterial. What is material, though, is the clearly expressed thought that the purpose was to establish depreciation charges for 1934 under a proceeding independent of the proceeding then pending before the Interstate Commerce Commission to establish rates to be effective after January 1, 1935.

That the state commission proposed to carry out this purpose is made more certain by the subsequent recitals and findings of the Commission.

The Commission stated:

> "In view of the fact that nearly all telephone service is intrastate, and the further fact that the State Commissions have regulatory power to fix reasonable rates for service, it is our opinion and we so find that Congress did not intend to authorize the Interstate Commerce Commission to prescribe depreciation rates, except for the sole purpose of establishing uniformity in depreciation accounting to the Interstate Commerce Commission, and for the purpose of aiding the State Commissions in fixing a depreciation rate. In other words, the Interstate Commerce Commission has the final word on depreciation accounting for the purpose of a uniform system of accounting to the Interstate Commerce Commission, and the State Commissions have the final word in fixing depreciation percentages as far as its accounting and reporting systems are concerned. It was clearly not the intention of Congress to deprive the State Commissions of their regulatory power to fix reasonable telephone rates." (R., pp. 7 and 8.)

Finding As to 1934 Rates

The Commission then made a finding as to the 1934 rates of depreciation, as follows:

> "An order should be entered directing all Class A and Class B telephone companies to file with this Commission, as soon as possible, and not later than March 1, 1934, the depreciation percentages they propose to use for 1934, with such available supporting data as is required by Schedules 1 and 2 attached to Depreciation Section Series Circular No. 7." (R., p. 8.)

Finding As to 1935 Rates

A further finding was made with regard to the estimates and supporting data required to be filed with the State

Commissions for recommendation to the Interstate Commerce Commission in connection with the 1935 rates of depreciation, which is as follows:

> "Another order should be entered directing all Class A telephone companies to file with this Commission, not later than August 1, 1934, their proposed depreciation rates for the year 1935, as required by the Interstate Commerce Commission in Docket No. 14700, and all supplemental orders pertaining thereto. A like order should be entered for all Class B telephone companies, except as to the respective dates." (R., p. 8.)

Order As to 1934 Rates

The Commission made the following order:

> "1. That all Class A and Class B telephone companies be and they hereby are ordered to file with this Commission not later than March 1, 1934, a schedule of depreciation rates by primary accounts, which they propose to apply for the year 1934, together with such supporting data as is required by the Interstate Commerce Commission in Schedules 1 and 2 attached to Circular 7, Depreciation Section Series." (R. p. 9.)

Order As to 1935 Rates

Other orders were entered with respect to the estimates and supporting data required to be filed August 1, 1934, in accordance with the orders in Docket 14700 (Depreciation Charges of Telephone Companies, 177 I. C. C. 351) with reference to depreciation rates for 1935 (R., p. 9).

Finding and Order As to Accounting Procedure

The Commission made the following finding:

> "The Commission is of the opinion and so finds that the procedure adopted by the Interstate Commerce

> Commission, for prescribing depreciation rates, should be adopted by this Commission, except that when the Interstate Commerce Commission shall have prescribed the rate of depreciation after hearings by this Commission and the recommendations of this Commission thereon, the said rate (fol. 14) should not be final, as far as accounting to this Commission is concerned, but subject to review by this Commission and a final order entered thereon." (R., p. 9.)

An order based on this finding was entered (R., p. 9).

Schedule and Estimates Filed As to 1934 Rates

In accordance with General Order No. 59, the Northwestern Bell Telephone Company, on February 28, 1934, filed separate schedules of its property included in telephone plant accounts as of January 1, 1934, and depreciation percentages for use during the year 1934 (R., pp. 10 to 17).

Further Order of Commission With Respect to 1934 Rates

On March 6, 1934, the Commission entered a further order, which is as follows:

> "Pursuant to our order of November 29th, 1933, the Northwestern Bell Telephone Company has filed with the commission its schedule of depreciation rates by primary accounts which it proposes to apply for the year 1934, together with the supporting data as required by the Interstate Commerce Commission in Schedules 1 and 2 of Circular 7, Depreciation Section Series, and the same having been examined by our Engineering staff and not being fully satisfied with the rates proposed, we find that the cause should be set down for hearing for oral examination of the members of respondent's staff, who prepared said schedules, and for the introduction of such evidence the Com-

mission may desire to submit with opportunity of objections and cross-examination by respondent.

"It is therefore ordered that the cause be set down for hearing on the 19th day of March, 1934, at the hour of 10 o'clock a. m., at the Commission's hearing room in the state capitol." (R., pp. 17 and 18.)

HEARING HAD UNDER ORDER OF MARCH 6, 1934

On March 19th and 20th a hearing was had in pursuance of the order of March 6th.

Appellant's brief contains some inaccurate statements as to what took place at the hearing in question, which should be corrected at this point. The brief states (p. 9):

"It was stated in view of the date thus fixed"—(to-wit: August 1, 1934, the date for filing data for 1935 depreciation)—"this material was not ready for presentation and consequently appellant would not undertake at that time to make any complete affirmative showing in support of its rates of depreciation, but construed the order of March 6th as directing the production of the persons who had compiled the summarized schedules required to be filed March 1, and that such witnesses were present and ready to answer such questions as might be asked them."

Again, it is stated (pp. 9-10):

"This hearing occurred on March 19th and March 20th and was confined to the answering of questions and the making of such explanations as the Commission and its engineers requested of these witnesses."

Neither of these statements is borne out by the record.

Scope of Hearing and Nature of Evidence Presented

When the hearing was convened on March 19, 1934, the appellant, Northwestern Bell Telephone Company, appeared by its attorneys and produced witnesses for examination by the Commission as to the data contained in the schedules of property and computation of depreciation percentages filed by them as aforesaid (R. p. 43).

The presiding Commissioner asked:

> "What order of procedure would you think proper, gentlemen?" (R., p. 43.)

To which counsel for appellant responded by specifying the witnesses who were present and stating that counsel would be glad to have the Commission ask any questions that they would care to, and would be glad to have the witnesses answer and furnish any information they could (R., pp. 43-44).

Mr. Granfield, the Inventory and Costs Engineer of the Northwestern Bell Telephone Company, under whom the rates of depreciation were compiled, was placed on the stand (R., p. 44), and after having answered a few preliminary questions as to his connection with the company, experience and familiarity with the data submitted (R., pp. 45 and 46), the question of procedure arose and it was stated by Mr. Forbes, Chief Engineer for the Commission, who conducted the examination of the witnesses on the part of the Commission, that he thought there should be a complete showing at one time, and that he understood that the company had supporting data which they were now preparing. Counsel for the telephone company stated that this was true, but that the supporting data was not all consolidated, which was aimed to be done so that the same

might be filed August 1, 1934, in accordance with the order of the Interstate Commerce Commission (R., p. 46).

The presiding Commissioner, Mr. Bollen, then stated:

> "I think, Mr. Forbes, your position would be good if this was August 1st instead of March 1st. This is simply for the fixing, of course, of the 1934 rate, and the Interstate Commerce Commission and we did not require as full a showing at this time as we expect to require for the 1935 rate. * * *." (R., pp. 46 and 47.)

Mr. Forbes then inquired of Mr. Granfield whether graphs were being prepared showing the trend and the life of different classes of property and things of that sort, to which Mr. Granfield responded as follows:

> "Yes, sir. For each class of plant we have the history summarized and are preparing brief texts discussing the factors that have been considered, and a summary of the historical data and an outline of the analysis giving the exact calculation of the service life and the salvage that has been realized, and that summary will be the result of summarizing an enormous volume of data. It takes thousands of pages, literally, to assemble these data of property units, and gradually boil them down into summaries that can be checked over in a reasonable time. For instance, we have volumes two or three inches thick giving the history of poles alone in one area, and that was summarized (fol. 65) and concentrated into a form from which the analysis was made, and the computation of the service life, by whatever method is used, will be shown in detail, and charts showing trend in service life and salvage for each class of plant." (R., p. 47.)

He was then asked by Mr. Forbes:

Q. "Do I understand you may change these percentages?"

A. "We are not expecting to, no, sir, but the data on which these percentages are based have not been summarized in a form that makes it convenient to present them and check them over. * * *." (R., p. 47.)

By Commissioner Bollen:

Q. "You didn't expect to have that prepared for this hearing, did you?" (R., p. 47.)

A. "No, sir. We were planning to get that done in time for the August hearing, for both this Commission and the Interstate Commerce Commission."

Q. "You have prepared for this hearing what was required by the Interstate Commerce Commission for this particular property?"

A. "Yes, sir."

"By Commissioner Bollen: It seems to me, Mr. Forbes, you could proceed to inquire into this for the purpose of the 1934 rate, and submit any data you desire to submit in connection with it." (R., p. 48.)

Mr. Forbes, representing the Commission, then offered in evidence the schedules of property and computations of rates of depreciation filed February 28, 1934, by the Northwestern Bell Telephone Company, as above referred to, which were received in evidence as Exhibit 1, and appear on pages 10 to 17 of the printed record (R., p. 48).

The witnesses present for the appellant were then examined by Mr. Forbes on behalf of the Commission, and also by counsel for the Northwestern Bell Telephone Company, appellant. When the examination of these witnesses was concluded, Mr. Schnell, Accountant for the Nebraska State

Railway Commission, was presented as a witness for the Commission (R., p. 187) and laid the foundation for certain exhibits which were introduced. The case was then submitted on the record (R., p. 194).

As bearing on the differences of interpretation placed upon the scope of the hearing by appellant and ourselves, we call attention to the findings of the State Supreme Court in that behalf which are hereinafter set out in this statement.

DECISION OF THE COMMISSION

On April 9, 1934, there was entered a certain opinion, findings, conclusions and order. The opinion is set out in the record at pp. 17 to 30.

Opinion

After stating that General Order No. 59 directed all Class A telephone companies to file with the Commission not later than March 1, 1934, a schedule of depreciation rates for the year 1934, setting out the proposed rates for 1934 as contained in the schedules filed by the Commission, and reciting the order of March 6, 1934, the opinion goes on to discuss the evidence adduced before the Commission at the hearing commencing March 19, 1934.

Page 2 of Exhibit 3 submitted by the Commission (R., p. 192) is set out showing the ratio of reserve for accrued depreciation to the plant investment of the company and the average annual percentage rate of the depreciation reserve from January 1, 1921, to December 31, 1932. The ratio of reserve to investment increased from 17.17 per cent January 1, 1921, to 28.23 per cent on December 31, 1926; then decreased to 23.60 per cent December 31, 1931, and

increased to 24.24 per cent in 1932. The annual composite depreciation rate was above 5% from December 31, 1921, to December 31, 1928, being 5.11 per cent at the former date and 5.09 per cent at the later date. It had decreased to 4.67 per cent on December 31, 1932. Reference is made to Exhibit 4 submitted by the Commission (R., p. 195), being an exhibit submitted by the respondent Northwestern Bell Telephone Company in a proceeding before the Commission in the year 1933, which showed an estimated 88 per cent condition of its Nebraska plant investment. The Commission, after examining a number of decisions of courts and commissions, quotes from Docket 14700, Depreciation Charges of Telephone Companies, 177 I. C. C. 351, as follows:

> "The principles are identical which govern the estimating of loss in service capacity for both accounting and valuation purposes. The same elements which produce depreciation for accounting purposes likewise produce depreciation for valuation purposes and they cannot properly be observed and taken into account in the one case and at the same time be overlooked and neglected in the other." (R., p. 25.)

The Commission then says:

> "We do not say that a depreciation reserve of more than 20 per cent of the value of the physical property is sufficient in all cases to take care of accrued depreciation. We do say that a depreciation reserve of 24.24 per cent of the value of physical property is more than sufficient to take care of 12 per cent accrued depreciation or an 88 per cent condition. The gradual reduction of its annual depreciation rates from 5.2 per cent in 1925 to 4.67 per cent in 1932 and a proposed rate of 4.48 per cent for the year 1934, is an admission that its rates have been too high in the past." (R., p. 25.)

The Commission then sets out in a table the amounts expended from 1921 to 1932 for replacements which were represented by debits to the depreciation reserve and for maintenance, the table showing that in the twelve years there was debited to the depreciation reserve $41,000,000.00 plus and there was expended for maintenance $57,000,000.00 plus. The Commission then comments on the fact that more has been spent for maintenance than for replacements and quotes from what was said by the Ohio Commission *In re Ohio Bell Telephone Company*, 2 P. U. R. (N. S.) 113 (R., p. 27). The Commission further comments as follows:

> "An important factor in determining the proper depreciation allowance is the maintenance policy of the company under consideration. This company has from the time of the merger in 1921 carried on a high standard of maintenance and kept its property in good condition and in a high state of efficiency. The line of demarcation between maintenance charge and depreciation charge is often quite dim and undoubtedly many items properly chargeable to reserve are handled as maintenance expense. Charges that would be considered a major requirement to a smaller utility are merely routine maintenance matter to a utility of the size of the present company." (R., p. 26.)

The Commission then says:

> "As compared with the Ohio Company the respondent has during the same years, spent a much larger sum for maintenance. This would indicate either that the respondent has maintained its Nebraska properties in a higher state of efficiency or that on account of deferred maintenance in 1921, it was necessary to spend more to bring respondent's property into a state of efficiency equal to the Ohio Company.

> "In ascertaining the amount required for annual depreciation it is first necessary to determine the service life of the several units of depreciable property. The factors determining service life are decay, wear and tear, physical deterioration, current action of the elements, obsolescence, inadequacy, demands of public authority and such other factors that are not restored by current maintenance. In determining accrued depreciation or percentage condition for ascertaining the fair value for rate making purposes, valuation engineers make inspection of the property to determine observed deterioration and do not give full consideration to the factors which determine the service life of the several units of property. We hold that the same factors should be considered by valuation engineers that are considered by the plant engineers and accountants in determining the required amount of annual depreciation. The differential of the respondent's actual depreciation and its depreciation reserve is probably due to this situation. The instant case presents a situation where it is the duty of the Commission to reduce the annual depreciation rate so it will gradually bring the accrued depreciation and the depreciation reserve into a fair relationship." (R., p 27.)

The Commission then discusses the factor which inadequacy has played in the matter of estimating annual depreciation rates prior to 1934. Statistics are set out which are taken from Exhibit 5, submitted by the Commission (R., p. 197), showing a much slower increase in the growth of population in the decade from 1920 to 1930 than prior to that time.

Exhibit 6, submitted by the Commission (R., p. 200), is also referred to, showing the falling off in the average number of telephones in use, it appearing that on December 31, 1929, there were in use, total stations 123,975, which

had fallen to 102,558 by December 31, 1933. The Commission then states:

> "This would indicate that inadequacy arising from growth will not be an important factor for 1934 and for several years thereafter. It should be out of the picture entirely as far as those exchanges are concerned in cities and towns of less than 3,000 population." (R., p. 28.)

Findings and Order of the Commission

The Commission then entered the following findings and conclusions and made the following order:

"We therefore find and conclude:

1. That the respondent's depreciation reserve of 24.24 per cent of its depreciable plant investment is more than is required to take care of actual depreciation of 12 per (fol. 38) cent and that the rate proposed by the respondent of 4.48 per cent for 1934 is excessive.

2. That the factor of inadequacy arising from growth will not be as important a factor in 1934 as it has been in the past and that respondent's proposed rate of 4.48 per cent will not be required for 1934.

3. That the differential now existing between respondent's depreciation reserve and its actual depreciation should be gradually reduced until its depreciation reserve more correctly reflects its actual depreciation.

4. That respondent's proposed depreciation rate of 4.48 per cent should be reduced until its present excess reserve capacity for service has been absorbed.

5. That a depreciation rate of 3½ per cent upon depreciable property including right-of-way be applied by the respondent for the year 1934.

ORDER

"It is therefore ordered by the Nebraska State Railway Commission that the composite depreciation rate of the Northwestern Bell Telephone Company be and the same is hereby fixed at 3½ per cent upon all of its depreciable property including right-of-way in Nebraska for the year 1934.

"It is further ordered that the Northwestern Bell Telephone Company be and is hereby directed to use a composite rate of 3½ per cent upon all of its depreciable property in Nebraska including right-of-way for the year 1934 for purposes of accounting and reporting to the Nebraska State Railway Commission." (R., pp. 30 and 31.)

Motion For Rehearing Filed and Overruled

Motion for rehearing was filed by the Telephone Company, April 12, 1934 (R., p. 31), and was overruled by the Commission (R., p. 35), although the wording of the first paragraph of the order was changed slightly so as to read as follows:

"It is therefore ordered by the Nebraska State Railway Commission that the composite depreciation rate of the Northwestern Bell Telephone Company be and the same is hereby fixed at 3½ per cent upon all of its depreciable property in Nebraska including right-of-way, for the year 1934."

DECISION OF STATE SUPREME COURT

On appeal to the Nebraska Supreme Court, judgment was entered March, 1, 1935 (R., p. 215), and the order of the State Railway Commission affirmed (R., p. 216).

Opinion of State Supreme Court

In its opinion the Nebraska Supreme Court says:

> "The matter is not here for trial de novo, but for judicial review as to the legality of the order of which appellant complains." (R., p. 218.)

The court further says (R., pp. 217-218):

> "Appellant presents four contentions:
>
> "First. That it was not given full notice of the scope of the hearing and full opportunity to make a defense in the 1934 depreciation rate; that therefore the order was void because it did not afford appellant due process of law under the state and federal Constitutions.
>
> "Second. That, since appellant is engaged in both interstate and intrastate commerce, and the congress has committed the matter of uniform accounting of common carriers of interstate commerce, including telephone companies, to the interstate commerce commission, the state commission was without authority to act on matters of accounting even with respect to intrastate commerce.
>
> "Third. That the order is void because it is not based on evidence sufficient to support it, and is contrary to the evidence.
>
> "Fourth. That the commission erred in denying the motion of appellant to vacate the order and to grant a hearing and a new trial." (R., pp. 217 and 218.)

As to the first contention, the court was of the opinion under the record that the appellant was afforded full notice of the scope of the proceeding and of the purpose of the Commission to fix the 1934 depreciation rate; that it had an opportunity to, and was permitted to introduce all

the evidence which it desired; that no objection was made on these grounds until after the decision, and concluded generally:

> "We think appellant had timely notice of the scope of the hearing, appeared generally, and was afforded due process of law in the matter." (R., p. 219.)

As to the second point, the Supreme Court came to the conclusion that inasmuch as the Interstate Commerce Commission (which than had accounting jurisdiction over common carrier telephone companies engaged in interstate business) had not acted under the authority bestowed upon it by Congress to prescribe annual depreciation charges, jurisdiction still subsisted in the Nebraska State Railway Commission to prescribe such rate (R., pp. 219-221). The court found the evidence sufficient to support the order, and found no reversible error (R., p. 221).

POINTS RELIED UPON BY THE APPELLANT UPON ITS APPEAL HEREIN

The appellant has filed herein a statement of points relied upon pursuant to rule 13 (R., p. 229) from which it appears that it complains:

I.

That it did not have notice of the scope of the hearing which was intended to be had for the purpose of fixing the 1934 depreciation rate, nor opportunity for presenting evidence in support thereof, and, hence, was not afforded due process of law.

II.

That the Nebraska State Railway Commission was without jurisdiction to prescribe the 1934 depreciation rate applicable to appellant's property, for that:

(a) The matter of the fixing of such rates was at all times controlled by the regulations of the Interstate Commerce Commission; and

(b) Because the order made by the Nebraska State Railway Commission was in conflict with the regulations and orders of the Interstate Commerce Commission, then in force prescribing the rules, principles and methods pursuant to which appellant was required to account for the expenses of depreciation.

III.

That the order of the Nebraska State Railway Commission was void for that it deprived appellant of property rights without due process of law and denied to appellant protection of the laws, in that:

(a) It deprived the appellant of the right to maintain true and accurate accounts recording the expenses of its business;

(b) It purports to require the use for accounting by appellant of a rate of depreciation which was intended to be, and in fact was, less than the true rate, in order to reduce the balance of appellant's depreciation reserve account.

The points relied upon by appellee will be found in the summary of argument which follows immediately at this point.

SUMMARY OF ARGUMENT

Point 1. The appellant was, in fact, as disclosed by the record, afforded full and sufficient notice of the scope of the hearing which was intended to be had before the State Commission for the purpose of fixing its 1934 depreciation rates, and was afforded full opportunity to present evidence and argument.

Hence, the proceedings before the State Commission were in themselves fully sufficient to afford due process of law.

Point 2. However, since the order of the State Commission, here complained of, is a legislative act, being in fact a state statute, due process would not require notice and hearing before its entry, but is satisfied by the fact that the order may be tested judicially to determine its lawfulness after notice and hearing in the state courts.

Point 3. Again, the order of the State Commission was merely an accounting order and did not affect the appellant in his property rights; under such circumstances, the question of due process does not arise.

Point 4. The Nebraska State Railway Commission had jurisdiction to fix the rates of depreciation to be employed by appellant as to its Nebraska property used in intrastate operations, and its jurisdiction was not affected either (1) by the provisions of Section 20 of the Interstate Commerce Act, bestowing on the Interstate Commerce Commission jurisdiction over uniform accounting of telephone companies engaged in interstate commerce; or (2) by the provisions added to said section by the Transportation Act of 1920 authorizing the Interstate Commerce Com-

mission to prescribe depreciation charges for such telephone companies, since the Interstate Commerce Commission had not assumed to fix depreciation charges under said section to be applicable in the year 1934.

Point 5. The order made by the Nebraska State Railway Commission was not in conflict with the regulations and orders of the Interstate Commerce Commission then in force prescribing the rules, principles and methods pursuant to which appellant was required to account for expenses of depreciation.

Point 6. The order is not obnoxious to the constitutional provision guaranteeing appellant due process of law either (1) on the ground that it requires the making of incorrect accounting entries, or (2) because it is not based upon any evidence in the record.

ARGUMENT

Point 1

The appellant was, in fact, as disclosed by the record, afforded full and sufficient notice of the scope of the hearing which was intended to be had before the State Commission for the purpose of fixing its 1934 depreciation rates, and was afforded full opportunity to present evidence and argument. Hence, the proceedings before the State Commission were in themselves fully sufficient to afford due process of law.

A. Full and Sufficient Notice Afforded

The appellant complains that it did not have notice of the scope of the hearing which was intended to be had for the purpose of fixing the 1934 depreciation rate, nor oppor-

tunity for presenting evidence and argument in support thereof, and, hence, was not afforded due process of law. It is for this reason that we have been at pains to set out in detail in the statement of the case herein a full account of the proceedings which were had and taken by the Commission which led up to and culminated in the legislative order fixing the depreciation rate for 1934 which is drawn in controversy on this appeal.

For the purpose of the discussion of this point, we assume, without conceding, that it is necessary that notice and hearing be afforded before legislative action may be taken by the Commission.

As pointed out in the statement above, the State Commission had plenary jurisdiction to regulate the rates, service and general control of the intrastate operations of the appellant telephone company.

In pursuance of this general power of regulation, it proceeded to, and did, enter a regulatory order fixing the rate of depreciation for the year 1934 on the property of the Northwestern Bell Telephone Company employed in intrastate operations.

The jurisdiction of the Commission to enter such an order is confirmed by the holding of the State Supreme Court as reflected in the second paragraph of the syllabus in the instant case:

> "Until the interstate commerce commission fixes the rates of depreciation upon local class A telephone company property for intrastate purposes, the state railway commission has jurisdiction and authority to prescribe such rates." (R., p. 216.)

Adverse counsel appear to have become confused by the fact that two subject-matters are discussed in General Order No. 59 (R., pp. 2 to 10, inclusive).

One subject dealt with in that order was the matter of estimates of depreciation rates and supporting data to be filed August 1, 1934, for the purpose of complying with the directions of the Interstate Commerce Commission in its order in Docket 14700 (Depreciation Charges for Telephone Companies, 177 I. C. C. 351) and supplements, and was designed to provide a basis for establishing depreciation rates for Class A telephone companies after January 1, 1935.

Another and entirely separate subject for action was the establishment of depreciation rates for the year 1934.

This matter is fully discussed in our statement of the case.

The appellant telephone company, on February 28, 1934, filed separate schedules of the property included in its depreciable plant accounts as of January 1, 1934, with estimates of service lives and salvage values and depreciation percentages proposed for use during the year 1934 (R., pp. 10-13).

On March 6, 1934, the Commission entered a further order in which it recites the filing of the schedules of depreciation rates for 1934 and states further:

> "The same having been examined by our engineering staff and not being fully satisfied with the rates proposed, we find that the cause should be set down for hearing for oral examination of the members of respondent's staff, who prepared said schedules, and

> for the introduction of such evidence the Commission may desire to submit with opportunity of objections and cross-examination by respondent." (R., p. 18.)

And it was further ordered the cause be set down for hearing on the 19th day of March, 1934 (R., p. 18).

On March 19th, date set for the hearing, the Northwestern Bell Telephone Company appeared by its attorneys; that the nature and scope of the hearing was clearly defined at the very inception thereof is disclosed by the statement which we have heretofore made.

The presiding Commissioner stated at least twice (R., pp. 46, 47 and 48) that the purpose of the hearing was to fix the 1934 rate. When Mr. Forbes, Chief Engineer for the Commission, suggested there should be a complete showing at one time, and that he understood that the company had supporting data which was being prepared to be filed August 1, 1934, the presiding Commissioner said to Mr. Forbes that his position would be good if this was August 1st instead of March 1st. He then stated:

> "This is simply for the fixing, of course, of the 1934 rate, and the Interstate Commerce Commission and we did not require as full a showing at this time as we expect to require for the 1935 rate." (R., pp. 46-47.)

And again it was stated by the presiding Commissioner:

> "It seems to me, Mr. Forbes, you could proceed to inquire into this for the purpose of the 1934 rate, and submit any data you desire to submit in connection with it." (R., p. 48.)

B. Specific Objections of Appellant As to Notice Considered.

Consideration is given at this point to the specific objections raised by appellant in its brief on the question of notice.

(1) Appellant's contention that there was no notice in this proceeding that the Commission had in contemplation the making of any order affecting the accounting in 1934 by appellant for the expense of depreciation.

Discussing the order of March 6, 1934, setting the cause down for hearing on March 19th (R., pp. 17 and 18), appellant says in his brief (p. 19):

> "The preceding course of this matter before the Commission had given it a well defined character as one looking toward the making of recommendations by the Commission to the Interstate Commerce Commission."

Appellant refuses to recognize the clear import of the order of the Commission entered November 29, 1933 (R., pp. 2 to 10), which, as we have heretofore pointed out, had to do with two separate subject-matters,—the first being the matter of co-operation with the Interstate Commerce Commission in fixing depreciation rates to be effective after January 1, 1935, and as to which data was to be filed on or before August 1, 1934, with the Commission;—the second, the matter of fixing the 1934 depreciation rates.

Appellant further says as to the order of March 6, 1934, which it terms a "notice":

> "There is nothing in this notice which suggested any controversy between any persons whatever, or any

issue to be tried or determined. * * * This surely falls far short of suggesting any issue which was to be resolved by the making of an order by the Commission." (Appellant's Brief, p. 19.)

The order of March 6, 1934 (R., pp. 17 and 13) recites that the schedules and data filed by the appellant telephone company have been examined by the Commission's engineering staff and that the Commission not being fully satisfied with the rates proposed find that the cause should be set down for hearing for oral examination of the members of the respondent staff who prepared such schedules, and for the introduction of such evidence as the Commission may desire to submit with opportunity of objections and cross-examination by respondent.

Notice was surely afforded:

(1) That the Commission was *not satisfied* with the schedules of depreciation rates submitted;

(2) That it desired to examine the members of the appellant's staff who computed them and were responsible for them,—in other words, the material witnesses who would be in a position to testify as to the accuracy or inaccuracy of these rates;

(3) That it proposed to introduce testimony *on its own behalf* with an opportunity to the appellant to object to the evidence presented by the Commission and to cross-examine its witnesses.

It would seem that the order itself would be sufficient to admonish one of ordinary intelligence that the schedules of depreciation rates filed with the Commission for application in 1934 were not going to be accepted by the Commis-

sion at their face value; that it intended to test their accuracy and to submit evidence of its own on the same subject-matter.

Coupled with this, of course, is the fact that at the hearing it was distinctly announced by the presiding commissioner that the purpose of the hearing was to fix the 1934 depreciation rate (R., pp. 46, 47 and 48).

It is suggested in appellant's brief that it was not the intention of the Interstate Commerce Commission in requesting information as to the 1934 rates to be filed with it as of March 1, 1934, to *satisfy* anyone in the sense of making out a case for the approval of its schedule of depreciation rates by public authority (Appellant's brief, p. 19).

Appellant here again confuses the issue. The order of the Nebraska State Railway Commission for data to be filed with it March 1, 1934, similar to that requested by the Interstate Commerce Commission was not in any way connected with the proceedings which were going forward before the Interstate Commerce Commission for the purpose of fixing depreciation rates to be effective after January 1, 1935, and in which the State Commission and the Interstate Commerce Commission were co-operating. It was for the distinct purpose of fixing depreciation rates for 1934 upon appellant's Nebraska property employed in intrastate operations. This distinction was made clear at the inception of the hearing by the statements made by Mr. Forbes, for the Commission, Mr. Peycke, for the appellant, and by the presiding Commissioner, Mr. Bollen (R., pp. 46, 47 and 48), which statements we have heretofore set out in detail in our statement of the case.

(2) Appellant's contention that the order of November 29, 1933, of the Nebraska Commission giving notice of the proceeding and the whole course of the proceedings in the matter then before it were inconsistent with the making of the order appealed from.

We think we have sufficiently demonstrated the dual character of the subject-matter contained in the order: That it referred not only to the fixing of depreciation rates in cooperation with the Interstate Commerce Commission, to be effective in 1935, but that it also had for its purpose the fixing of depreciation rates to be applied upon appellant's Nebraska property used in intrastate operations for the year 1934.

(3) Appellant's contention that the purpose of the proceeding had been disclosed to be that of securing information for the purpose of making recommendations to the Interstate Commerce Commission, and no other purpose had been suggested.

What we have said under the preceding subdivisions applies *a fortiori* here.

It is true that the Nebraska State Railway Commission expressed its intention to cooperate in the proceedings which were being had before the Interstate Commerce Commission to fix the 1935 rates (R., p. 8), but it is not true that there was no other purpose expressed by the State Commission. It plainly expressed its purpose to establish the depreciation rates of the appellant for 1934, both in its order of November 29, 1933, and at the hearing on March 19, 1934.

(4) Appellant's contention that the Nebraska Commission adopted the principles and procedure which the Interstate Commerce Commission had laid down.

This is true as to the matter of cooperation in fixing depreciation rates for 1935. The fact, however, has no pertinency so far as the determination of depreciation charges for 1934 are concerned. Appellant fails to point out any procedure laid down by the Interstate Commerce Commission with respect to the 1934 rates. Depreciation Circular No. 7 did not prescribe any procedure beyond the filing of the rates for the information of the Commission. Appellant contends (Brief, p. 5), and it may be correct, that the circular did not even require filing with the State Commission. If no procedure was provided, how could it be adopted?

(5) Appellant's contention that the order is inconsistent with the principles and requirements of the Interstate Commerce Commission and is therefore inconsistent with the principles which the commission had in this very proceeding formally announced that it embraced and adopted.

Whether the Commission's order is in conflict with any applicable regulations of the Interstate Commerce Commission is discussed in a later section of this brief. See Point 5.

(6) Appellant's contention that the Nebraska Commission had clearly announced its intention to make no order having to do with any question as to jurisdiction as between state and federal authority until after the fixing

of rates of depreciation by the Interstate Commerce Commission had been fully accomplished.

It is true that the Commission in its order did consider the possible conflict in jurisdiction between the federal commission and the state commission, but decided their spheres were not necessarily in conflict. It announced its purpose to cooperate with the Interstate Commerce Commission in the proceedings pending to establish depreciation charges for 1935; approved the procedure adopted by the Interstate Commerce Commission looking to that end, but as to the fixing of depreciation charges to be applied intrastate in Nebraska, reserved the right to review the same. This, however, as we have repeatedly pointed out, had no connection with and was a separate subject from the matter of depreciation rates for 1934, concerning which there was no proceeding pending before the Interstate Commerce Commission.

C. Full Opportunity Afforded to Present Evidence and Argument.

Appellant (Brief, p. 27) quotes what was said by this court in *The New England Divisions Case*, 261 U. S. 184, at p. 200:

> "A full hearing is one in which ample opportunity is afforded to all parties to make, by evidence and argument, a showing fairly adequate to establish the propriety or impropriety, from the standpoint of justice and law, of the step asked to be taken."

It is urged by appellant that it was not afforded an opportunity to address itself by evidence and argument to the issue which was to be resolved by the decision of the

Nebraska State Railway Commission. The contention of appellant seems to be based upon the supposed insufficiency of the notice which it received as to the scope of the hearing,—that is, the issue which was to be dealt with thereat. We think we have sufficiently demonstrated hereinbefore that the notice of the scope of the hearing was entirely adequate. If the appellant did not have a full hearing, it was not by reason of the lack of opportunity so to do. Its witnesses were present. Its counsel was present. It participated in the hearing through its counsel, who questioned not only the witnesses who represented the appellant company but the witness adduced by the Commission. No question as to notice or hearing was raised until motion for rehearing was filed (R., p. 31). At the time the motion for rehearing was argued and submitted, the appellant telephone company asked leave to and was permitted to file Exhibit 7, being the First Revised Issue of the Uniform System of Telephone Accounts issued by the Interstate Commerce Commission (R., p. 41).

The motion for rehearing (R., p. 31) while it complains that the order of the Commission was made without affording respondent an opportunity to be heard, does not specify any further or additional evidence which was available to it or which it might have produced at the hearing.

It is not shown that appellant's counsel expressed any desire for argument except on the motion for rehearing where they were fully heard (R., p. 33), but it certainly does not appear that they were ever denied argument.

Further, as pointed out by the State Supreme Court, there was no attempt made by the appellant telephone company, although it knew, or should have known, that

the Commission was about to fix its 1934 depreciation rate, to introduce any other or further evidence, but the cause was submitted on the record at the conclusion of the examination of the witnesses produced by the company, and the Commission's own witness (R., p. 194).

The State Supreme Court disposed of the matter of notice and hearing, as follows:

> "As to the claim that appellant had no sufficient notice of the scope of the hearing, the record shows that it appeared and for two days participated in the hearings and furnished its schedules showing the rates of depreciation on various kinds of property owned and used by it. * * * But when the record shows that all the evidence was taken that either party desired to offer and that the cause was submitted on the record without objections of any sort until after the decision, we think we ought not, in such a case, to reverse the action on the ground that, after the judgment was entered against a party, it can then claim it was taken by surprise as to the (fol. 306) scope of the action. Indeed, even after the final order was entered, on the hearing of the motion for new trial, the parties stipulated (and it appears in the bill of exceptions) on May 15, 1934, for the admission of additional evidence. This was incorporated in the bill of exceptions in the form of a book of 101 pages on Uniform System of Accounts for Telephone Companies, issued by the interstate commerce commission in 1933. Until the motion for rehearing was filed, setting up the points now relied on, the record does not show that the commission as a court had any notice that appellant was aggrieved by the procedure. The evidence shows that counsel for the telephone company at the outset of the hearing suggested names of parties having to do with the calculation of the rate. Most of these were examined at length in a hearing apparently conducted with all the formality of any court. It

appears all through the evidence that what the commission and telephone company were seeking was the proper evidence upon which to base a proper rate of depreciation to be used by the commission in 1934 only. If the telephone company had offered or proposed to offer other or further evidence and had been refused the opportunity, it would have presented a different question than that now before us. We think appellant had timely notice of the scope of the hearing, appeared generally, and was afforded due process of law in the matter." (R., pp. 218-219.)

Full notice and opportunity for hearing were afforded appellant in the proceedings before the Commission.

Point 2

However, since the order of the State Commission, here complained of, is a legislative act, being in fact a state statute, due process would not require notice and hearing before its entry, but is satisfied by the fact that the order may be tested judicially to determine its lawfulness after notice and hearing in the state courts.

(a) The order complained of is a legislative act.

It is stated in plaintiff's petition for appeal (R., p. 223):

"2. * * * The statute of the State of Nebraska, the validity of which was so drawn in question, was the said order of the Nebraska State Railway Commission, made and entered April 9, 1934. The decision and judgment of said Supreme Court was in favor of the validity of said order and statute of the State of Nebraska. The errors of which petitioner complains appear from the assignments of error presented and filed with this petition."

> "3. Petitioner further shows that for the reasons aforesaid this case is one in which under the legislation in force when the act of January 31, 1928 (45 Stat. L. 54) was passed, to-wit, under Section 237 (a) of the Judicial Code (28 U. S. C. A, Sec. 344) a review could be had in the Supreme Court of the United States on writ of error."

The applicable portion of Section 237 of the Judicial Code as amended (28 U. S. C. A., Section 344 (a)) is as follows:

> "A final judgment or decree in any suit in the highest court of a state in which a decision in the suit could be had * * * or where is drawn, in question the validity of the statute of any state on the ground of its being repugnant to the Constitution, treaties or laws of the United States and the decision is in favor of its validity may be reviewed by the supreme court upon a writ of error * * *."

The Act of January 31, 1928 (45 Stat. L. 54) was effective merely in changing the procedure from writ of error to appeal.

If the said order is a statute of the State of Nebraska within the meaning of Section 237 of the Judicial Code, an appeal would lie to this court. *King Mfg. Co.* v. *City Council, Augusta,* 277 U. S. 100; *Sultan Ry. & Timber Co.* v. *Department of Labor and Industries of the State of Washington,* 277 U. S. 135; *Hamilton* v. *Regents of the University of California,* No. 55, October Term, 1934, L. Ed. Adv. Ops., Vol. 79, p. 159.

This court has noted probable jurisdiction on this appeal, indicating its tentative acceptance of this theory.

If this theory is correct and the order is, in fact, a legislative act, the order in question should be judged, as to due process, by such criteria as are ordinarily applied in case of legislative enactments.

(b) Legislative acts do not require notice to interested parties nor hearing on their behalf before action is taken. It is sufficient if an opportunity be afforded for review in the courts of the state, on sufficient notice and hearing, for the purpose of testing the lawfulness of the legislative act after its enactment.

The doctrine of due process of law had its original in the 39th Chapter of Magna Carta, which in its fullest and most complete sense is taken by most commentators to include a prohibition against the taking of property except by the law of the land.

While the fundamental idea underlying this guarantee has subsisted from the earliest days of the common law, still the requirements to be exacted in order that the guarantee might be preserved have undergone distinct development and changes. For example, in the earlier stages of the law the inquiry as to due process was directed largely to the right of jury trial. Later the requirement of notice and hearing was developed and it is with this later doctrine that we have here to do. *Mott on Due Process of Law* (pp. 208 and following).

A reference to the work of Professor Mott, above referred to, discloses the fact that the courts have found the criterion of notice and hearing too strict for universal application. It has, therefore, been cut down to the minimum with respect to determinations of administrative tri-

bunals, only such notice and hearing being required as the nature of the proceeding renders it possible to afford without loss of adequacy and efficiency. With regard to legislative acts, we have not been able to discern any inclination on the part of the courts to require notice or hearing *before* the act is passed. *After* the act is passed, the question of its lawfulness is, of course, a judicial question and as to this question there must be provided the means for a judicial determination after notice and hearing.

It will be noted that there is a distinction between the *action* of the legislature which does not require notice or hearing, and the determination of the *reasonableness or lawfulness* of its action, which is a judicial question and must, therefore, be open for determination in the courts.

Applying the distinction to the order of the Commission here in question, we are satisfied that it was not necessary that the appellant be afforded notice and hearing of the action taken by the Commission in the entry of the order. Of this it cannot complain. It is sufficient, if it was afforded the opportunity for a judicial determination as to the reasonableness of the Commission's order in the courts of the state. This affords due process, such as is ordinarily and customarily accorded with relation to legislative enactments.

The principles which we have above set out are exemplified in the case of *Wadley Southern Railway Co.* v. *State of Georgia*, 235 U. S. 651. In that case there was drawn in question an order of the State Railway Commission directing a carrier by rail to desist from discrimination practiced by denying shippers the right of interchange of freight via a certain junction point. On failure of the carrier to

comply, a suit to enforce a penalty was brought in the Georgia courts and the carrier there pleaded that the order of the Commission, and the statute on which it was based, took property without due process of law, in violation of the provisions of the 14th Amendment. The case was, of course, decided with regard to the nature and character of the penalty imposed for violation of the order, and whether it was so excessive in amount that the liability to have it imposed affected the carrier's right to test the validity of the Commission's order in the court. It was necessary, however, to examine the nature of the order made by the Commission and to discuss its effect, and in so doing the court said:

> "This contention would have been well founded if this and other hearings of a like nature before the commission had resulted in orders which had the characteristics of a final judgment. But this was not so, for they were not conclusive. *Chicago, M. & St. P. R. Co.* v. *Minnesota*, 134 U. S. 418, 458, 33 L. ed. 970, 981, 3 Inters. Com. Rep. 209, 10 Sup. Ct. Rep. 462, 702. Their lawfulness was treated by the Georgia court in the present case as open to inquiry, when the company was sued for a penalty. The question of their validity was also open to inquiry, in equity proceedings, in the state court, where they would have been set aside if found to be arbitrary and unreasonable, or to have violated some statutory or constitutional right. *Railroad Commission* v. *Louisville & N. R. Co.*, 140 Ga. 817 (6a), 836, L. R. A. 1915E, 902, 80 S. E. 327; *State* v. *Western & A. R. Co.*, 138 Ga. 835, 76 S. E. 577; *Southern R. Co.* v. *Atlantic Sand & Supply Co.*, 135 Ga. 50, 68 S. E. 807. Such orders were also subject to attack in the Federal courts on the ground that the party affected had been unconstitutionally deprived of property. *Louisville & N. R. Co.* v. *Garrett*, 231 U. S. 313, 58 L. ed. 242, 34 Sup. Ct. Rep. 48, and cases cited. And this right to a judicial determination

exists whether the deprivation is by a rate statute—passed without a hearing (as in the Young and Consolidated Gas Cases); or by administrative orders of a commission, made after a hearing (as in the Garrett Case, supra). For rates made by the general assembly, or administrative orders made by a commission, are both legislative in their nature (Garrett Case, supra; *Grand Trunk Western R. Co.* v. *Railroad Commission*, 221 U. S. 403, 55 L. ed. 787, 31 Sup. Ct. Rep. 537), and any party affected by such legislative action is entitled, by the due process clause, to a judicial review of the question as to whether he has been thereby deprived of a right protected by the Constitution. *Chicago, M. & St. P. R. Co.* v. *Minnesota*, 134 U. S. 418, 458, L. ed. 970, 981, 3 Inters. Com. Rep. 209, 10 Sup. Ct. Rep. 462, 702; *Chicago, M. & St. P. R. Co.* v. *Tompkins*, 176 U. S. 174, 44 L. ed. 420, 20 Sup. Ct. Rep. 336; *Prentis* v. *Atlantic Coast Line Co.*, 211 U. S. 210, 53 L. ed. 150, 29 Sup. Ct. Rep. 67; *Missouri P. R. Co.* v. *Nebraska*, 217 U. S. 207, 54 L. ed. 731, 30 Sup. Ct. Rep. 461, 18 Ann. Cas. 989; *Washington ex rel. Oregon R. & Nav. Co.* v. *Fairchild*, 224 U. S. 510, 56 L. ed. 863, 32 Sup. Ct. Rep. 535; *San Joaquin & K. R. Canal & Irrig. Co.* v. *Stanislaus County*, 233 U. S. 459, 58 L. ed. 1046, 34 Sup. Ct. Rep. 652; *Bacon* v. *Rutland R. Co.*, 232 U. S. 134, 58 L. ed. 538, 34 Sup. Ct. Rep. 283; *Detroit & M. R. Co.* v. *Michigan R. Commission*, 235 U. S. 402, ante, 288, 35 Sup. Ct. Rep. 126.

"The methods by which this right to a judicial review are secured vary in different jurisdictions. In some states there is a provision that within a designated time the order may be reviewed by the courts on the evidence submitted to the commission. *Washington ex rel. Oregon R. & Nav. Co.* v. *Fairchild*, 224 U. S. 510, 56 L. ed. 863, 32 Sup. Ct. Rep. 535; *State ex rel. Railroad Commission* v. *Oregon R. & Nav. Co.*, 68 Wash. 160, 167, 123 Pac. 3; *Seward* v. *Denver & R. G. R. Co.*, 17 N. M. 557, 46 L. R. A. (N. S.) 242, 131 Pac. 980. Cf. *Oregon R. & Nav. Co.* v. *Campbell*, 173

Fed. 957, 989. In others, by proceedings in equity. In the Federal Courts the method of procedure, when administrative orders are attacked as unconstitutional, is now regulated by section 266 of the Judicial Code (36 Stat. at L. 1162, chap. 231), as amended (37 Stat. at L. 1014, chap. 160; Comp. Stat. 1913, sec. 1243)."

Wadley S. R. Co. v. *Georgia*, 235 U. S. 405, 411, 59 L. Ed. 660.

In the case of *C. B. & Q. R. R. Co.* v. *State of Nebraska*, 170 U. S. 57, the court had to do with an ordinance of the City of Omaha which provided for the repair of a viaduct over certain railroad tracks and apportioned the expense between railroad companies without notice to them. Action was brought, on the relation of the City of Omaha, for mandamus, requiring one of the railroads concerned to comply with the ordinance and repair the viaduct. It was contended that the ordinance did not afford due process to the company for the reason that no notice or hearing was afforded before the taking of its property. This court, however, upheld the action of the State Supreme Court in affirming a judgment of the State court of first instance in awarding mandamus, saying:

"So, in the present case, while no notice may have been given to the railroad companies of the pendency of the ordinance, and while they may not have been invited to participate in the proposed legislation, yet they had an opportunity to, and did in fact, put in issue, by the answer, both the validity of the ordinance and the reasonableness of the amount apportioned to them respectively for the repair of the viaduct in question.

"The validity of the statute and of the ordinance having been passed upon and upheld by the courts of the state, it is not the function of this court, apart

> from the provisions of the Federal Constitution supposed to be involved, to declare state enactments void, because they seem doubtful in policy and may inflict hardships in particular instances."

In the case of *Vandalia R. R. Co.* v. *Public Service Commission of Indiana*, 242 U. S. 276, the court had to do with a statute of the state of Indiana conferring upon the Railway Commission authority to investigate the condition and efficiency of headlights in use on locomotive engines on railroads in the state, and, after determining the most practicable and efficient headlight, to make and enforce the necessary orders for the installation thereof. Pursuant to this authority, an investigation was conducted, the result of which was an order requiring the use of headlights of a certain determined candle power. The plaintiff in error, a railroad affected by the order, brought an action in the state court to enjoin the enforcement of the order, on the ground that, among other things, it was repugnant to the due process clause of the 14th Amendment.

It was recognized that the State Supreme Court had so construed the statute in question as to be supplementary to other legislation which gave to any carrier or other party dissatisfied with any order of the Commission the right to resort to the courts in an action to suspend it or set it aside. Since, however, this court found that there had been a notice and full hearing before the Commission, this question was not controlling. Nevertheless the conclusion of the court was based on both propositions,—namely: that notice and hearing had been afforded before the Commission and that the railroad had been afforded and had exercised the

right to a judicial review in the courts of the state, the court saying:

> "Since the order in question was made after notice and a full hearing, and plaintiff in error had and exercised the right to a judicial review by action at law, we concur in the view of the state court that there has been in this respect no deprivation of property without due process of law." (P. 286.)

Of course, where the order of the Commission is final and the law of the State does not afford a judicial review, and no notice or hearing has been had prior to the order made by the Commission, an entirely different situation is presented. In such case this court has held that due process of law is not afforded, as in *C. M. & St. P. R. R. Co.* v. *State of Minnesota,* 134 U. S. 418.

We are satisfied, however, that the requirements of due process are fully met under the laws of the State of Nebraska, and that due process would be afforded even though the order in question had not been preceded by notice and a full hearing.

(c) The order of the Nebraska State Railway Commission was subject to a judicial review for lawfulness in the courts of the State of Nebraska.

(1) Remedy by Appeal

The statutes of the State of Nebraska (Section 70-505, Compiled Statutes, 1929) provide for an appeal to the Supreme Court of Nebraska on the part of anyone dissatisfied with an order of the Nebraska State Railway Commission.

The scope of such appeal is indicated by the statement of the State Supreme Court in its opinion in the instant case (R., p. 218):

> "The matter is not here for trial de novo but for judicial review as to the legality of the order of which appellant complains."

Under the statute above quoted, if the State Supreme Court found that the commission's order of which the appellant complains was so unreasonable as to be confiscatory, or to deny equal protection of the law, it had full power to reverse the order and set it aside.

(2) Remedy by Injunction

Appellant urges, however, that this remedy by appeal would not be sufficient to afford due process of law since the cause would be heard on the same record as was made before the State Commission.

It is urged that if the appellant was denied notice and hearing before the Commission, the record would not reflect all the evidence which it might be able to produce to establish the unreasonableness or unlawfulness of the order. Assuming, but not conceding, that there has been shown to be any evidence available to appellant which was not in substance adduced before the Commission at the hearing which was had on March 6, 1934, still we think this objection would be obviated by the fact that the appellant had the right to apply either to the state courts or to the federal courts for an injunction against the enforcement of the order, if in fact it was so unreasonable as to be confiscatory or to deny equal protection of the laws.

Since the remedy by appeal affords a remedy which is ordinarily adequate and complete, it would not in the nature of things ordinarily happen that a party appearing before the Commission would resort to the equity courts to enjoin an order of the Commission even though it was deemed to be utterly void. The injunction suit would be brought in a court of first instance, inferior to the State Supreme Court, and subject to review in that court, and, hence, the remedy by injunction would be more cumbersome in that an additional hearing would be required, and more delay and expense would be incurred, than if a direct appeal were taken to the State Supreme Court. It so happens that to our knowledge no such suit has been so instituted in the District Courts of the state and taken on appeal to the Supreme Court of the state, hence, we are not able to cite any decisions of our Supreme Court in which the right to enjoin the enforcement of an unconstitutional order of the Commission has been upheld in express terms.

However, the State Supreme Court has held that an unconstitutional law is as though it had never been. *Boales* v. *Ferguson,* 55 Neb. 565; *Finders* v. *Bodle,* 58 Neb. 57; *State* v. *Several Parcels of Land,* 78 Neb. 703; *Anderson* v. *Lehmkuhl,* 119 Neb. 451. In fact, the court has said in regard to such a law:

> "It was fatally smitten by the Constitution at its birth."
>
> *Boales* v. *Ferguson*, 55 Neb. 568.

Under such circumstances, should it be attempted to enforce an unconstitutional legislative order of the Commission, and the property rights of a party were affected thereby so as to submit his property to confiscation, and to cause him irreparable injury, we make no doubt that our

Supreme Court would hold that an injunction would lie to prevent the enforcement of such order. This is the general rule, 32 C. J. 243.

Indeed, this is indicated by what was said by the State Supreme Court in the instant case with reference to the order here complained of, fixing rates of depreciation:

> "It was for 1934 only and steps had already been taken to fix the rate for 1935. If the rate should prove to be confiscatory, if and when applied, it is quite likely the appellant will be able to discover a remedy." (R., p. 221.)

We cannot place any other construction upon this statement than that the State Supreme Court was of the opinion that if the rate of depreciation prescribed for application in 1934 should prove to be confiscatory in light of the future experience of the company, and when given application in a rate case, the appellant telephone company might in such instance invoke the power of equity to enjoin its application.

It so happens, however, that in the federal jurisdiction, there have been reported cases, arising in this state, where resort has been had to equity in order to enjoin orders of the Commission which were complained of as confiscatory or otherwise violative of complainant's constitutional guaranties.

In fact the appellant, in this case, the Northwestern Bell Telephone Company, sought and obtained a permanent order of injunction against the State Commission in the federal district court of Nebraska to prevent the enforcement of certain intrastate telephone exchange rates on the

ground of confiscation. *Northwestern Bell Telephone Company* v. *Nebraska State Railway Commission* (1925), 6 Fed. (2d) 663.

See also:

Mo. Pac. Ry. Corp. v. *Nebraska State Ry. Com.*, 65 Fed. (2d) 557.

We are satisfied that this remedy is open under proper circumstances, in either the State or the Federal courts of Nebraska.

Point 3

Again, the order of the State Commission was merely an accounting order and did not affect the appellant in its property rights; under such circumstances, the question of due process of law under the 14th Amendment to the federal constitution does not arise.

The constitutional guaranty of due process of law is for the protection of life, liberty and property. If none of these objects of protection are involved, the constitutional guaranty may not be invoked. The order complained of, as amended on the hearing on the motion for rehearing, is as follows:

> "It is therefore ordered by the Nebraska State Railway Commission that the composite depreciation rate of the Northwestern Bell Telephone Company be, and the same is, hereby fixed at 3½ per cent upon all of its depreciable property in Nebraska including right-of-way for the year 1934." (R., p. 35.)
>
> "It is further ordered that the Northwestern Bell Telephone Company be, and is, hereby directed to use a

composite rate of 3½ per cent upon all of its depreciable property in Nebraska including right-of-way, for the year 1934, for purposes of accounting and reporting to the Nebraska State Railway Commission." (R. p. 31.)

It will be noted that the rate of depreciation is directed to be used for *purposes of accounting and reporting to the Nebraska State Railway Commission.*

It is a matter of common knowledge that the Northwestern Bell Telephone Company is an operating company united with other like organizations under the general control of the American Telephone and Telegraph Company and commonly known as the "Bell System." This court had recently before it, in the cases of *Smith* v. *Illinois Bell Telephone Company*, 282 U. S. 133, and *Lindheimer* v. *Illinois Bell Telephone Company*, 292 U. S. 151, the matter of annual depreciation charges made by the Illinois Bell Telephone Company, another member of the Bell system. We may say that the system of depreciation valuation and accounting, described by this court in the *Lindheimer* case, is identically the same as is used by the Northwestern Bell Telephone Company and testified to by their witnesses in the instant hearing.

Mr. Justice Hughes, in delivering the majority opinion in the *Lindheimer* case, stated (p. 167):

> "Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence. Annual depreciation is the loss which takes place in a year. In determining reasonable rates for supplying public service, it is proper to include in the operating expenses, that is,

in the cost of producing the service, an allowance for consumption of capital in order to maintain the integrity of the investment in the service rendered. The amount necessary to be provided annually for this purpose is the subject of estimate and computation. In this instance, the Company has used the 'straight line' method of computation, a method approved by the Interstate Commerce Commission. 177 Inters. Com. Rep., pp. 408, 413. By this method the annual depreciation charge is obtained by dividing the estimated service value by the number of years' of estimated service life. The method is designed to spread evenly over the service life of the property the loss which is realized when the property is ultimately retired from service. According to the principle of this accounting practice, the loss is computed upon the actual cost of the property as entered upon the books, less the expected salvage, and the amount charged each year is one year's pro rata share of the total amount. Because of the many different classes of plant, some with long and some with short lives, some having large salvage and others little salvage or no salvage, and because of the large number of units of a class, the Company employs averages, that is, average service life, average salvage of poles, of telephones, etc.

"While property remains in the plant, the estimated depreciation rate is applied to the book cost and the resulting amounts are charged currently as expenses of operation. The same amounts are credited to the account for depreciation reserve, the 'Reserve for Accrued Depreciation.' When property is retired, its cost is taken out of the capital accounts, and its cost, less salvage, is taken out of the depreciation reserve account. According to the practice of the Company, the depreciation reserve is not held as a separate fund but is invested in plant and equipment."

Mr. Granfield, the Inventory and Costs Engineer of the appellant telephone company, makes substantially the same

statement in his evidence as to the general nature of depreciation and the method of computation. Since we have no idea that this statement will be controverted, it is perhaps unnecessary to make reference to the record, since many observations are scattered through the entire record of the testimony which bear in some way upon this question. However, the testimony of Mr. Granfield, together with that of Mr. Baird (who was injected from time to time to answer accounting questions during the course of the examination of Mr. Granfield) was devoted generally to the explanation of the nature and necessity of establishing a reserve for depreciation, and the method and form which was employed by the company for expressing the same upon their books in what is termed "Depreciation Accounting," as appears on pages 48 to 89 of the record.

The point to which we desire to call attention at the present time, however, is the point to which Mr. Justice Hughes calls attention, and that is that, according to the practice of the company, the depreciation reserve is not held as a separate fund but is invested in plant and equipment. Mr. Granfield, examined on this point, stated (R., p. 83):

> Q. "Can your accountant tell us the per cent of your depreciation reserve that is actually invested in plant?"
>
> A. "I think the accounting people can tell how much that is."
>
> Q. "When you invest it in plant, you add that to the plant investment?"
>
> A. "Yes, sir, all of our plant investment."
>
> Q. "Upon which you claim a fair return?"
>
> A. "Yes, sir."

(Fol. 129.) Q. "Would you be able to answer that question for the record, and make our story continuous here?"

"By Mr. Baird:

A. "The question is what per cent of the reserve is now invested in plant?"

Q. "Yes."

A. "We didn't indicate on the assets side as to whether it is reserve or not. Looking at the balance sheet, however, you will find that it must be mostly in the plant, because there are no such sums in the other assets. There is no way to tag it. We didn't tag it."

Q. "Could you state from examining, or refreshing your memory, about what per cent of your present reserve is invested in plant?"

A. "I have no way of knowing, except that there are no items in the assets side that anywheres near approximate the amount of the depreciation reserve, except one item of investments and securities. We have thirty-two million in reserve, and our assets of a hundred and forty-eight million. There is a hundred and thirty million in plant. The only large items other than plant is the investments and securities and advances of twelve million nine hundred thousand, and twenty-five hundred thousand in receivables, but how much is in one and how much in the other. I would have no way of knowing." (R., p. 83.)

There are methods of depreciation accounting which actually provide a sinking fund which has a distinct existence apart from the capital accounts and surplus account of the utility. Where such a sinking fund has been set up and invested, a change in the rates of depreciation would, of course, directly affect the property held in that fund.

The method of "straight line" accounting employed by the appellant telephone company does not, however, affect directly or indirectly the amount or character of any capital or surplus account. What is done is to present a picture of the present state of the company's depreciable property. The original book cost is indicated and also the amount which will be necessary sooner or later to be expended, to preserve the investment.

A change in the rate of depreciation does not mean the taking of any money out of the capital accounts, nor out of the surplus, but merely that the picture presented by the balance sheet is changed by showing that a less amount will be necessary to preserve the investment than as previously indicated.

This picture of conditions is equally important to the company and to the regulatory commission: That each may be apprised of the actual conditions as they exist with respect to the status of the plant investment.

It is important that the reserve for depreciation be sufficient in amount, as otherwise the company might distribute in dividends moneys which should be applied to the retirement of property.

It is equally important that the depreciation reserve shall not be excessive, as pointed out by this court in the *Lindheimer* case. This results in earnings being "plowed under" into the capital accounts, so that the stockholders are paid dividends upon moneys actually contributed by the ratepayers. In addition to this, it is pointed out by practical accountants that excessive rates of depreciation serve to build up *secret reserves*. It is said of the policy of main-

taining excessive depreciation reserves, in *Kester* on *"Accounting, Theory* and *Practice,"* Volume 2 (The Ronald Press Company, 1918), pp. 204 to 205:

> "The effect of such a policy, if operated without check, is to create what is known as a 'secret reserve.' The value of the asset is charged more rapidly against operation than the asset actually wastes. Hence the books show a reserve sufficient to cover the cost of asset while there are still values remaining in the asset. In other words, the business possesses an asset of value which is carried on the books as of no value. Were the real present value of the asset brought on the books, the contra credit would appear in some surplus or *profits* reserved account. Such would constitute a true record of the item, openly stated. So long as the asset remains concealed, i. e., without record on the books, its contra credit is also latent and constitutes a *secret* reserve of profits.
>
> "A too liberal depreciation policy, if recognized and adjusted at the time of a reappraisal, will require a separation from the depreciation reserve of the portion brought about by the overallowance, and its showing as a part of the surplus. When so handled, an overcharge for depreciation has no permanently bad effect except as it may show, for purposes of comparison, too high costs of production for the period overburdened. However, it may be and sometimes is, used for purposes of fraud and therefore, as a fixed policy, the practice of the secret reserve is to be condemned."

It is, of course, true that if a utility is compelled in a rate case to set up too low a figure for its depreciation for the purpose of establishing the rate base, it will result that the rates established for the service of the utility to its patrons may be so lowered as to affect the return on its investment. However, this cannot happen until a rate case actually arises and the rates to patrons are actually re-

duced so as to affect the earnings of the company. In such case, there may be actual confiscation of property. However, the mere fixing of the reserve for depreciation at too low a figure for the purpose of accounting does not have this result. It results only, as we have said, in a figure on the balance sheet which may be too low. If so, the company is at liberty for purposes of management and operation to disregard it, and to substitute therefor the purpose of their own calculation, such figure as they deem proper. Stated differently, the rate of depreciation fixed by a regulatory commission for the purpose of accounting to that commission does not necessarily bind the company to regard that figure as the proper figure for the purpose of management and operation.

Indeed, as we conceive it, there is nothing in the Uniform System of Accounts prescribed by the Interstate Commerce Commission, and shown in the record here, to prevent the utility from complying with the request of the regulatory commission in setting up the depreciation reserve in accordance with its requirements, and, in addition, carrying a separate account representing the difference between their own estimate of the required depreciation reserve and that prescribed by the commission. This might, indeed, be done under the express terms of the Uniform System of Accounts, for the purpose of developing the fact that the Commission was mistaken and securing a revision of its order at a later date.

The provision to which we have reference is that part of the order of the Interstate Commerce Commission, made with regard to the adoption of the Uniform System of Accounts on November 11, 1932:

> "It is further ordered, That any such carrier or any receiver or operating trustee of any such carrier, in

addition to the accounts hereby prescribed, may, unless otherwise ordered, keep any temporary or experimental accounts the purpose of which is to develop the efficiency of operation: Provided, however, That such temporary or experimental accounts shall not impair the integrity of any primary account hereby prescribed." (R., p. 202.)

We also refer to the provisions contained in the instructions in said Uniform System of Accounts 2. * * * (C) * * * (3) (R., p. 206):

"Temporary or experimental accounts may be kept in addition to the accounts prescribed herein, for the purpose of developing the efficiency of operations, etc., provided such accounts do not impair the integrity of any accounts prescribed herein."

The fact that an accounting order does not affect the property of the company until actually applied in a rate case, was recognized by this court in the case of *State Corporation Commission for the State of Kansas* v. *Wichita Gas Company*, 290 U. S. 561. That case had to do with an investigation made by the Kansas Commission into the charges made by holding companies for service rendered and commodities furnished to certain distributing companies furnishing natural gas to consumers in Kansas. It directed them to give the Commission such information as they might see fit and as the Commission might require. It ordered them to show cause why charges made by any holding company, if found unreasonable, should not be disallowed as operating expenses. After extensive hearings, the commission entered two orders,—the first of which directed the distributing companies to cease setting up as an expense item payment to the pipe line company for gas in excess of 30c per thousand cubic feet, and to give no con-

sideration to the payments so disapproved in fixing rates to domestic customers. The court says, as to this order (pp. 568 to 570):

> "The first order does not purport to establish or prescribe prices to be paid by the distributing companies to the pipe line company or purport to establish any rate to be charged by appellees to their customers. It merely directs the distributing companies not to include in their operating expense accounts more than 30 cents per thousand cubic feet for gas furnished by the pipe line company and not to consider any payments in excess of that price in fixing a rate for domestic consumers.
>
> "We need not decide whether these provisions are repugnant to the Constitution or whether they are otherwise invalid. The invalidity of such an order is not of itself ground for injunction. Unless necessary to protect rights against injuries otherwise irremediable, injunction should not be granted. *Terrace* v. *Thompson,* 263 U. S. 197, 214, 68 L. ed. 255, 44 S. Ct. 15. Appellees in substance suggest that, unless now adjudged invalid and enjoined, the findings and directions of the commission in respect of their operating expenses and the fixing of rates will be binding upon them in later proceedings for the prescribing of rates to be charged by them for gas furnished to consumers and in suits involving the validity of such rates. But the commission's proceedings are to be regarded as having been taken to secure information later to be used for the ascertainment of reasonableness of rates. The order is therefore legislative in character. The commission's decisions upon the matters covered by it cannot be res adjudicata when challenged in a confiscation case or other suit involving their validity or the validity of any rate depending upon them. *Prentis* v. *Atlantic Coast Line R. Co.,* 211 U. S. 210, 227, 53 L. ed. 150, 159, 29 S. Ct. 67; *Chicago, M. & St. P. R. Co.* v. *Minnesota,* 134 U. S. 418, 452, et seq., 33 L. ed.

970, 977, 10 S. Ct. 462, 3 Inters. Com. Rep. 209, but the decisions of state courts reviewing commission orders making rates are res adjudicata and can be so pleaded in suits subsequently brought in federal courts to enjoin their enforcement. *Detroit & M. R. Co.* v. *Michigan R. Commission*, 235 U. S. 402, 405, 59 L. ed. 288, 289, 35 S. Ct. 126; *Napa Valley Electric Co.* v. *Railroad Commission*, 251 U. S. 366, 373, 64 L. ed. 310, 313, 40 S. Ct. 174, P. U. R. 1920C, 849. The appellees were not obliged preliminarily to institute any action or proceeding in the Kansas court in order to obtain in a federal court relief from an order of the commission on the ground that it is repugnant to the Federal Constitution. *Bacon* v. *Rutland R. Co.*, 232 U. S. 134, 138, 58 L. ed. 538, 539, 34 S. Ct. 283; *Missouri* v. *Chicago, B. & Q. R. Co.*, 241 U. S. 533, 542, 60 L. ed. 1148, 1155, 36 S. Ct. 715; *Ex parte Young*, 209 U. S. 123, 166, 52 L. ed. 714, 732, 28 S. Ct. 441, 13 L. R. A. (N. S.) 932, 14 Ann. Cas. 764. And upon the issue of confiscation vel non they are entitled to the independent judgment of the courts as to both law and facts. *Ohio Valley Water Co.* v. *Ben Avon*, 253 U. S. 287, 289, 64 L. ed. 908, 914, 40 S. Ct. 527, P. U. R. 1920E, 814; *Bluefield Waterworks & Improv. Co.* v. *Public Serv. Commission*, 262 U. S. 679, 689, 67 L. ed. 1176, 1181, 43 S. Ct. 675; *United R. & E. Co.* v. *West*, 280 U. S. 234, 251, 74 L. ed. 390, 411, 50 S. Ct. 123.

"It results, therefore, that appellees in their complaints failed to state facts sufficient to entitle them to a decree enjoining the appellants from enforcing the first order for as insisted by appellants in oral argument in this court, the challenged provisions are merely preliminary steps in aid of investigations for the ascertainment of the reasonableness of appellee's rates, and they have no binding force in respect of payments to the pipe line company or rates to be charged consumers and cannot be res adjudicata. The decree in so far as it enjoins enforcement of the provisions of that order will be vacated."

As pointed out by the court in the Wichita Gas Company case, just examined, the action of the State Commission in the instant case is to be regarded merely as a preliminary step taken at this time for future reference in cases having to do with the fixing of appellant's intrastate exchange and toll rates. The orders of the State Commission do not constitute *res judicata*. *Holmberg* v. *C. St. P. M. & O. Ry. Co.*, 115 Neb. 727.* When and as such rate cases arise, the order may be considered as to whether it is confiscatory in its effect. It is plain that at the present time it has no such effect.

Point 4

The Nebraska State Railway Commission had jurisdiction to fix the rates of depreciation to be employed by appellant as to its Nebraska property used in intrastate operations, and its jurisdiction was not affected either (1) by the provisions of Section 20 of the Interstate Commerce Act, bestowing upon the Interstate Commerce Commission jurisdiction over uniform accounting of telephone companies engaged in interstate commerce; or (2) by the provisions added to said section by the Transportation Act of 1920, authorizing the Interstate Commerce Commission to prescribe depreciation charges for such telephone companies, since the Interstate Commerce Commission had not assumed to fix depreciation charges under said section to be applicable in the year 1934.

It is urged by appellant that the order appealed from is void for the reason that the action already taken by federal authority respecting accounting by appellant for the expenses of depreciation completely occupied the field of

*This case was reversed on other grounds in *C. St. P., M. & O. Ry. Co.* v. *Holmberg*, 282 U. S. 162.

regulation of that subject, and precluded any regulation thereof by state authority.

We must not confuse the regulations promulgated by the Interstate Commerce Commission with regard to uniform accounting with the rules prescribed for the purpose of fixing depreciation charges. It is true that the Interstate Commerce Commission had promulgated a uniform system of accounts long prior to the entry of the order in this case, and that, as a necessary incident, depreciation was required to be accounted for in these accounts. However, the power to fix depreciation charges was not bestowed upon the Interstate Commerce Commission until the amendment of Section 20 (par. 5) by the Transportation Act of 1920, and we have heretofore in this brief pointed out that the effective date of the rules adopted looking toward the ultimate establishment of depreciation charges by the Interstate Commerce Commission was postponed from time to time, the date fixed by the order of June 5, 1933, being January 1, 1935; that no proceedings were pending which contemplated the fixing of depreciation charges to be applicable to, or to be included in any accounts for the year 1934; that such proceedings as were pending had to do with depreciation charges to be effective subsequent to January 1, 1935.*

*We might, in addition, point out that after the order entered in this case on April 9, 1934, the Federal Communications Act was passed by the Federal Congress, effective June 19, 1934; that the proceeding for determination of depreciation rates was taken over by the Federal Communications Commission as Docket 2552, and the effective date of the orders theretofore made by the Interstate Commerce Commission in Docket 14700 and the Federal Communications Commission in Docket 2552 were by Order No. 10-B, dated May 1, 1935, indefinitely postponed by the Federal Communications Commission. Appellant having in a footnote on page 34 of its brief seen fit to refer to the proceedings pending before the Federal Communications Commission, it would seem proper to refer to their present status.

It seems to be appellant's contention, however, that the exercise of jurisdiction by the Interstate Commerce Commission over accounting generally, has ousted the Nebraska State Railway Commission from that field. An attempt is made to distinguish between jurisdiction for accounting and jurisdiction for regulation. We do not think that accounting may be so easily divorced from regulation. Jurisdiction for the purpose of accounting can be sustained only on the theory that it is a necessary incident to regulation. The purpose of Congress in authorizing the Interstate Commerce Commission to prescribe a uniform system of accounts for carriers was to enable the Commission intelligently to perform its duties with respect to regulation; to ascertain whether forbidden practices and discriminations were concealed in certain accounts; whether charges of expense were made against one part of their business which ought to be made against another; and to give such information as might be of value with respect to the regulation of rates. *Kansas City Southern Ry.* v. *U. S.*, 231 U. S. 423; *I. C. C.* v. *Goodrich Transit Company*, 224 U. S. 194.

We steadfastly maintain that there is nothing in the mere fact of the bestowal of accounting jurisdiction over companies engaged in interstate business, upon the Interstate Commerce Commission, which necessarily ousts state commissions from control of that particular phase of regulation so far as concerns intrastate operations.

The exercise of dual authority in the field of regulation as between Federal Commissions and State Commissions is not a new problem. The same problem is presented by the dual control exercised over common carriers by rail by the Interstate Commerce Commission and the various State Commissions,—the chief difference being that in the

case of carriers by rail by far the greater volume of business is in most instances interstate, whereas with regard to telephone companies by far the greater volume of business,—perhaps 85 to 90 per cent, is intrastate.

It is well settled that the mere fact that a portion of the property of a common carrier may be devoted to interstate commerce does not remove it from the control of the state and place it under sole federal supervision under the provisions of the Interstate Commerce Act.

A case has recently been decided by the Circuit Court of Appeals for the eighth circuit, which originated in Nebraska, and by reason of an order of the Nebraska State Railway Commission, which is extremely instructive upon this phase of the controversy. We refer to the case of *Missouri Pacific Railroad Corporation in Nebraska* v. *Nebraska State Railway Commission*, (C. C. A. 8th Cir.) 65 Fed. (2d) 557. The Missouri Pacific Railroad Corporation was operating a belt or switching railway, located wholly within the city of Omaha. It was directed by the Nebraska State Railway Commission to receive shipments originating on the lines of other and competing carriers and to deliver them at its team or public sidetracks on the payment of a prescribed switching charge. It was the contention of the railroad company that many of the shipments handled involved interstate commerce, and that even though the facility in question was located wholly within the State of Nebraska, the Nebraska State Railway Commission had no jurisdiction to direct a joint use of the belt line and team tracks with competing railroads, nor had it the right to prescribe charges for such use.

It was contended there, as here, that Congress, by virtue of the Interstate Commerce Act, had committed to the In-

terstate Commerce Commission full control over the rates, service and facilities of common carriers so far as they were engaged in Interstate Commerce, and that this excluded the Nebraska Railway Commission from exercising jurisdiction in that behalf. This proposition was ruled adversely to the contention of the railroad company and on petition for writ of certiorari this court refused to review the decision (78 L. ed. 78).

An examination of the authorities which deal with the right of the Interstate Commerce Commission to exercise control over intrastate commerce convinces us that it was never the intention of Congress to vest the Interstate Commerce Commission with any jurisdiction as to intrastate matters, except only so far as it might be necessary to the effective regulation of interstate commerce. Where the nature of the regulation required is such that it must of necessity affect both interstate and intrastate commerce, because they are so interwoven and interlocked that it is impossible or impracticable to treat them separately, it is undoubtedly true that the jurisdiction of the Interstate Commerce Commission would be exclusive; but where it is possible for the State Commission to exercise jurisdiction solely over the intrastate business and to do so without interference with interstate business, we think this may be done.

Such dual control is not contrary to the purpose and intent of the Interstate Commerce Act, which was not designed to interfere with purely intrastate commerce, but to leave such commerce under the control and regulation of state commissions so far as it might be possible to do so without impeding, interfering with, or unduly burdening interstate commerce.

An illustration of this principle is afforded by *Board of Railroad Commissioners* v. *Great Northern Railway Company*, 281 U. S. 412.

In that case it is clearly pointed out that the Interstate Commerce Commission and state commissions each have their proper sphere in the making of rates, and that it was not the intention of the Congress to circumscribe the power and authority of state commissions in that regard unless, and except, the rates fixed by the state commissions are unduly discriminatory as against interstate traffic, and, therefore, subject to revision under the 13th Section of the Interstate Commerce Act.

This court in that case quoted with approval from the case of *Railroad Commission* v. *C. B. & Q. R. R. Co.*, 257 U. S. 563, 590, 591, as follows:

> "It is said that our conclusion gives the Commission unified control of interstate and intrastate commerce. It is only unified to the extent of maintaining efficient regulation of interstate commerce under the paramount power of Congress. It does not involve general regulation of intrastate commerce. Action of the Interstate Commerce Commission in this regard should be directed to substantial disparity which operates as a real discrimination against, and obstruction to, interstate commerce, and must leave appropriate discretion to the state authorities to deal with intrastate rates as between themselves on the general level which the Interstate Commerce Commission has found to be fair to interstate commerce."

Again, where abandonment has been sought under the provisions of Section 1 (18) of the Interstate Commerce Act, this court has held that the Interstate Commerce Commission has no authority to authorize discontinuance of a

purely intrastate portion of a railroad whose situation and ownership are such that interstate and foreign commerce will not be burdened or affected by a continuance of that portion.

State of Texas v. *Eastern Texas Railroad Company*, 258 U. S. 204.

In *Grand Trunk Railway Company* v. *Michigan Railroad Commission*, 231 U. S. 457, the expressions of the court afford a criterion as to the general policy of the Congress over the matter of control of intrastate traffic, which we think has never been departed from.

Paragraph 2 of the syllabus is as follows:

> "Congress has not so taken over the whole subject of terminals, team tracks, switching tracks, sidings, etc., of interstate railways as to invalidate all state regulations relative to the interchange of traffic."

Likewise in the Los Angeles Depot cases, both in the case reported in 264 U. S. 331, and in the case reported in 283 U. S. 380, it was recognized that the State Commission of California had, and might exercise, far-reaching and potent authority with regard to the construction of a union terminal station at Los Angeles, even though the terminal in question also served interstate traffic.

Appellant strenuously insists there is such essential conflict between compliance with the uniform system of accounts prescribed by the Interstate Commerce Commission and the fixing of depreciation charges for the year 1934 by the Nebraska State Railway Commission that the jurisdiction of the latter to fix such depreciation charges as an incident of its general power of regulation over telephone companies must yield to the Federal power of regulation

as exercised in prescribing the uniform system of accounts. Appellant, however, has totally failed to point out any such essential conflict.

As we have heretofore pointed out in this brief, there is a distinction between a uniform system of accounting, wherein provision is made for depreciation accounts, but no rules prescribed for determining the amount of depreciation charges, and a system of orders and rules adopted by the Interstate Commerce Commission providing a course of procedure looking to the prescription of such depreciation charges, themselves, by the Interstate Commerce Commission.

We may consider the provisions of the uniform system of accounts with regard to depreciation charges only so far as they were applicable on April 9, 1934, the date of the Commission's order here complained of.

Since the effective date of the First Revised Issue Uniform System of Accounts for Telephone Companies (Exhibit 7) had been postponed from January 1, 1933, to January 1, 1935 (R., p. 4), the rules and regulations with regard to estimates to be made and data to be furnished by the companies as contained in Rule 80 (R., pp. 210-212) were not in effect when the order complained of was entered by the State Commission. Not even the provision set out on page 33 of appellant's brief, to-wit:

> "'the company's estimates of composite annual percentage rates computed in accordance with instruction 80 shall be used prior to the date rates prescribed by this commission become effective.' (Instruction 81 (C), R. 212-213.)"

was effective.

The only regulation, if it is a regulation, that was effective April 9, 1934, when the Commission made its order was the *proviso* contained in the order of the Interstate Commerce Commission of date June 5, 1933, postponing the effective date of the First Revised Issue, Uniform System of Accounts for Telephone Companies to January 1, 1935, to-wit:

> "*Provided*, That nothing in the foregoing shall be construed as relieving telephone companies from accounting for depreciation by the application to the primary plant accounts of composite annual percentage rates based upon the best estimates available of service lives and salvage values, as required by the Uniform System of Accounts for Telephone Companies, First Revised Issue."

This we take to be merely a permissive provision. It is not to be considered as an approval, without consideration, of any depreciation rates which the company might see fit to adopt for its own use. The company-made rates were not consecrated.

Where rates of depreciation had been prescribed on intrastate property used in intrastate operations by a commission validly empowered so to do as a necessary incident to its power of regulation of intrastate business, the company would not be violating the rules of the Interstate Commerce Commission if it complied with the order of the state commission and made such correction in its rates of depreciation as was necessarily involved in a compliance with the orders of the State Commissions.

Finally, we believe that the decision of this court in the case of *Smith* v. *The Illinois Bell Telephone Company*, 282 U. S. 133, precludes all real objections to the exercise of

the power of fixing depreciation charges as a necessary incident to regulation by a state commission,—at least until the Interstate Commerce Commission or its successor, the Federal Communications Commission, shall have acted. This court said in that case:

> "The company urges that, as Congress has granted jurisdiction to the Interstate Commerce Commission over the depreciation rates of telephone companies doing an interstate business (Interstate Commerce Act, Sec. 20 (5), as amended by Transportation Act (February 28), 1920, U. S. C. title 49, Sec. 20), this subject is now completely withdrawn from the power of the state. It is said that two rates of depreciation cannot be charged on the same property. The Interstate Commerce Commission has had the matter under consideration (Re Telephone & R. Depreciation Charges, 118 Inters. Com. Rep. 328-333), but, so far as we are advised, a final determination has not yet been made. The Interstate Commerce Commission has its accounting rules with reference to depreciation charges and, pending its order under Sec. 20 (5) of the Interstate Commerce Act, telephone companies, as well as others subject to the act, have been directed to continue to observe these requirements. The company argues that, although the Interstate Commerce Commission has not finally ruled, the action taken by Congress excludes the jurisdiction of state tribunals under familiar principles. *Northern P. R. Co.* v. *Washington*, 222 U. S. 370, 378, 56 L. ed. 237, 239, 32 S. Ct. 160; *Pennsylvania R. Co.* v. *Public Service Commission*, 250 U. S. 566, 569, 63 L. ed. 1142, 1145, P. U. R. 1920A, 909, 40 S. Ct. 36; *Oregon-Washington R. & Nav. Co.* v. *Washington*, 270 U. S. 87, 102, 70 L. ed. 482, 488, 46 S. Ct. 279. We are unable to assent to this view. As the Interstate Commerce Commission has not acted finally in the matter, we are not now called upon to consider the scope of its authority in relation to depreciation charges, but we are of the

opinion that, in any event, until action has been taken which could be deemed validly to affect the amount to be charged to depreciation in connection with intrastate business so as to affect intrastate rates, the prerogative of the state to prescribe such rates, and the jurisdiction and duty of the statutory court in considering their validity to determine the amount properly allowable for depreciation in connection with the intrastate business, are not to be gainsaid. Compare *Railroad Comrs.* v. *Great Northern R. Co.*, 281 U. S. 412, 74 L. ed. 936, 50 S. Ct. 391. Accordingly, the court should make appropriate findings with respect to the amount to be allowed in this case as an annual charge for depreciation in connection with the intrastate business." (pp. 159-160.)

See also:

Indiana Bell Telephone Co. v. *Public Service Commission,* 300 F. 191, 205.

Appellant contends that the *Smith* case is not to be followed as a binding precedent here for the reason that this is purely an accounting case, whereas the *Smith* case was a rate case in which the court had under consideration the reasonableness of the rates prescribed by the State Commission and that the State Commission there fixed a proper charge for depreciation only as a necessary incident to arriving at a proper rate base.

We cannot, however, distinguish these two cases in principle. The Nebraska State Railway Commission has plenary jurisdiction over the rates, service and general control of all common carriers within the state, including telephone companies. (See sub-title "Jurisdiction of State Commission" in statement.) For the purpose of such regulation it has exercised the power of prescribing depreciation charges. It is true that the matter of these charges is not

of present moment in any rate case now pending before the State Commission, as it was in the *Smith* case, but the matter of proper depreciation charges will undoubtedly be of vital importance in future rate cases before the State Commission, in which the Northwestern Bell may be involved. Stated differently, in the *Smith* case the matter of proper depreciation charges was a material matter for present application in a rate case. As regards the instant order made by the Nebraska State Railway Commission, the matter of proper depreciation charges is not a matter for present application, but is a matter for future application in rate cases, when and as they may arise. However, the power to fix such charges will be equally as important to the patrons of the Northwestern Bell Telephone Company when and as rate cases arise, as it was to the patrons of the Illinois Bell Telephone Company in the *Smith* case, where a rate case was already pending.

We insist that since no action had been taken by federal authority to fix rates of depreciation for application to the property of appellant located in Nebraska and used in intrastate operations, the power subsisted in the State Commission to fix such rates.

Whether the State Commission might so act after the Federal Commission had acted, is not involved in this case and need not and should not be considered here.

Point 5

The order made by the Nebraska State Railway Commission was not in conflict with the regulations and orders of the Interstate Commerce Commission then in force prescribing the rules, principles and methods pursuant to

which appellant was required to account for the expenses of depreciation.

The supplemental order of June 5, 1933, entered by the Interstate Commerce Commission in Docket 14700, which postponed the effective date for depreciation accounting to January 1, 1935, carried the following provision (R., p. 5):

> "*Provided*, That nothing in the foregoing shall be construed as relieving telephone companies from accounting for depreciation by the application to the primary plant accounts of composite annual percentage rates based upon the best estimates available of service lives and salvage values, as required by the Uniform System of Accounts for Telephone Companies, First Revised Issue."

It must be apparent, therefore, that the provisions of the said First Revised Issue of the Uniform System of Accounts for Telephone Companies, the pertinent portions of which are set out in the record from pages 203 to 214, inclusive, are not applicable to reports required to be made to the Interstate Commerce Commission for the year 1934, except as indicated in the above *proviso* in the order of June 5, 1933.

The Interstate Commerce Commission requested Class A telephone companies to submit not later than March 1, 1934, a schedule of the rates by primary accounts which they proposed to apply during that year, together with a statement of the estimated service lives and salvage values upon which such rates were based. It was particularly stated in Depreciation Section Circular No. 7:

> "In order that the Commission may be informed as to the rates contemplated for use by the respective companies for the year 1934, each Class A and Class B

telephone company is requested to submit not later than March 1, 1934, a schedule of the rates by primary accounts which it proposes to apply during that year, together with a statement of the estimated service lives and salvage values upon which such rates are based.

"In view of the fact that the estimated rates covered by the schedules to be submitted by Class A companies August 1, 1934, and by Class B companies August 1, 1935, must be accompanied by the necessary supporting data, and it is assumed that the preparation of these is receiving appropriate consideration at this time, the only requirement with respect to the rates submitted in response to this request is that the service lives and salvage values shown shall be based upon the best information readily available. In other words, for the purpose of the returns (fol. 10) to be made under this circular the details supporting the service lives and salvage values used will not be required." (R., p. 5.)

The Commission, in its General Order No. 59, required Class A telephone companies to submit not later than March 1st, their schedule of depreciation rates by primary accounts, together with such supporting data as required by the Interstate Commerce Commission by Circular No. 7, Depreciation Section Series (R., p. 9). These schedules were filed with the Railway Commission (R., pp. 10 to 17).

It will thus be seen that the schedules and data filed with the Commission were in strict conformity with the only requirements insisted upon by the Interstate Commerce Commission for depreciation accounting in connection with reports to be filed prior to January 1, 1935.

What the Commission did was to examine the responsible members of the appellant telephone company's staff,

who had prepared the same, and to introduce testimony of its own bearing upon the same subject-matter.

It then, acting within its regulatory powers, fixed a rate of depreciation to be applied for the year 1934 upon the intrastate depreciable property of the appellant.

Appellant contends that this action is in conflict with Article VI, paragraph 2, of the Constitution of the United States, because "it is directly in conflict with the requirements validly imposed by the Interstate Commerce Commission." Before addressing ourselves to the specific objections set out by counsel, we would call attention to the expressions of the Interstate Commerce Commission itself, as contained in its report preliminary to its order of July 28, 1931, Docket 14700, Depreciation Charges of Telephone Companies, 177 I. C. C. 351. In the finding in this report, which had to do with the matter of procedure which should be set up by the Commission for the purpose of fixing depreciation rates, the Commission says:

> "In the case of telephone companies such estimates and the accompanying statements shall be filed, within the time prescribed, with the State Commission or Commissions having jurisdiction over the particular company, * * *." (P. 446.)

The finding then proceeds:

> "In the case of steam railroad companies this commission shall, after an office check, prescribe by temporary order the percentages of depreciation which shall be charged with respect to each class of property of each company, and in the case of telephone companies this commission shall by temporary order prescribe similar depreciation percentages, following the recommendations of the State commissions to the extent that such advice can be procured." (P. 446.)

The finding then provides for public hearings after the issuance of the temporary orders, and continues:

> "In the case of telephone companies, such public hearings shall be conducted for this commission, so far as possible, by State commissions."

We call attention to the fact that the Interstate Commerce Commission directed the required data to be filed in the first instance with the State Commission having jurisdiction over the particular company. This recognizes a regulatory authority in the State Commission over the telephone companies which would be affected by the order.

It then provides for the issuance of temporary orders, based upon the recommendations of the State Commissions, to the extent that such advice can be procured. This recognizes the fact that the state regulatory commissions may propose changes or alterations in the rates which the telephone companies may be proposing to apply; and, in effect, directs that such changes and alterations shall be given temporary effect by the mandate of the Interstate Commerce Commission until public final hearing is had by the Interstate Commerce Commission.

It is further provided that the public hearings which are to be had are to be conducted so far as possible for the Interstate Commerce Commission by the State Commissions.

We cannot discern from the above any purpose on the part of the Interstate Commerce Commission to deny regulatory jurisdiction to the Commissions over intrastate matters. Neither can we discern any purpose to require the State Commissions to adhere rigidly to any set of rules laid down by the Interstate Commerce Commission to the exclusion of changes or alterations that might be suggested

therein by the State Commissions. On the contrary, the Interstate Commerce Commission seems to invite full cooperation on the part of the State Commissions. It gives effect as a temporary proposition to such changes or alterations as they may make in the rates proposed by the company and finally provides that the public hearing which shall be had shall be conducted for the Interstate Commerce Commission by the State Commission.

We discern nothing in the provisions of the order of June 5, 1933, nor in those of Depreciation Section Circular No. 7, to which we have above adverted, which in any way detracts from the expressions of the Interstate Commerce Commission in its order of July 28, 1931. We are satisfied that there is no provision in the order of the State Commission which in any way conflicts with the rules of the Interstate Commerce Commission in effect at the date it was entered.

We will now consider appellant's specific objections.

1. **Accounting Separately by Classes of Plants**

There is nothing either in the supplemental order of June 5, 1933, nor in the Depreciation Section Circular No. 7, requiring a separate rate of Depreciation to be set out for each of the twelve different classes of telephone plants. That was a totally new provision introduced for the first time by the First Revised Issue, Uniform System of Accounts for Telephone Companies, and had not, of course, come into effect at the time the order in this case was made, but, even if the rules of the Commission can be so stretched as to be taken to require the application of separate percentage rates to the various classes of depreciable telephone plants, still this would not militate against the

validity of the order entered by the Commission. It is complained that an annual composite percentage is prescribed for application to all depreciable property, and that this cannot be broken down into proper components to apply to the twelve separate plant accounts.

In its schedules filed February 28, 1934, before the Nebraska State Railway Commission, the appellant, as Schedule 1, Sheet 1, filed a schedule of property included in telephone plant accounts as of January 1, 1934, and depreciation percentages for use during the year 1934. Column 1 gives the number and title of primary accounts covering depreciable property. Column 2 gives their ledger value January 1, 1934. Column 3 gives the depreciation rates proposed to be applied to each account. Column 4 gives the estimated annual depreciation charges.

At the foot of the statement appears the following:

> "Estimated annual composite rate of depreciation for all depreciable accounts—determined by dividing the total estimated depreciation charges shown in column 4 by the total ledger value of all depreciable accounts shown in column 2....4.48%." (R., p. 10.)

It is this rate which is referred to by the Commission as the rate of depreciation proposed by the company, and in place of that rate the Commission prescribed a rate of 3.5%.

It must be apparent that the amount of the estimated annual depreciation charges for each account bear a certain ratio to the total thereof. Having ascertained that ratio, it should be a simple matter of mathematics to break down the composite rate prescribed by the Commission into such components as will reduce the separate depreciation

rate for each primary account, in due proportion. This calculation could not, perhaps, be readily made monthly, but it certainly could be made at the end of the accounting period and the proper correction entries made at that time.

2. Straight-line Depreciation Accounting

Neither the order of June 5, 1933, nor Depreciation Section Circular No. 7, issued by the Interstate Commerce Commission, contain any reference to straight-line accounting. However, we have little objection to assuming, since the company had adopted that system, that it would be required to adhere to it, the more because we are convinced that the order of the Commission did not interfere with the pursuit of that method by the company. Appellant, in its brief, seems to seek to convey the idea that estimates for the purpose of depreciation charges are fixed and definite quantities and that they may not be changed and varied once it has been determined what aliquot part is to be assigned to each accounting period. We do not so construe the straight-line system of accounting. It is true that an estimate is made of service life and salvage value and that the residue is divided into parts equal in number to the number of accounting periods,—that is, normally, into a number of parts corresponding to the number of years of service life. However, these estimates of service life and salvage value are not constant. They are variables. They are based on studies of the experience of the company and on the judgment of engineers as to what the future will bring. They must constantly be revised in the light of experience. This was recognized by the Interstate Commerce Commission in its order in Docket 14700, Depreciation Charges of Telephone Companies, 177 I. C. C. 351. The Interstate Commerce Commission said:

"In connection with this general subject, also, the question arises as to how errors in depreciation rates which are brought to light by further experience and subsequent check shall be corrected, so far as the depreciation reserve is concerned. As indicated above, one of the claims advanced for the unit basis is that it results in an automatic adjustment of errors. This claim, however, rests upon a misapprehension. It is true that under that basis the depreciation charges on account of a unit stop when it has reached the estimated average life, and that if it is retired short of that life any deficiency in the accruals is charged to operating expense. But clearly this manner of automatic adjustment will not correct the current charge to operating expense on account of depreciation, if the depreciation rate is in error. Nor will it necessarily correct the depreciation reserve, in view of the large amount of property always existing, particularly where the plant is growing, which neither has been retired nor yet has reached the average age. Verification of the depreciation reserve, as has already been shown, must depend upon the verification of the depreciation rates. If the latter are found to have been wrohg in the past, the depreciation reserve will be wrong, whether the group or the unit basis be employed. The natural procedure, under such circumstances, would be to correct the reserve gradually, either up or down, by appropriate modification of the depreciation rates for this purpose." (pp. 446-447.)

The State Commission became convinced that the rates of depreciation which had been applied in the past were too high; that the factor of inadequacy which had been taken into account during the last decade on account of the growth and development of the company no longer had as important a place as it formerly had; that the conversion of the type of service from magneto and grounded circuit to common battery, metallic circuit, and in case of the larger

exchanges to dial equipment, had progressed about as far as it naturally would; that the reserve already set up by the company was excessive,—that is to say, it was more than sufficient to replace the capital of the company which might be retired during the present service life of the plant now in operation. The method adopted was to lower the annual composite percentage rate for all depreciable property for the year 1935. The idea was not to provide for retirements during that year, but so to adjust the total of the reserve that it would perform its proper function. This is exactly what was done by the Illinois State Commission in the case of *Lindheimer* v. *Illinois Bell Telephone Company*, 292 U. S. 151, and the action of the Commission there was held to be justified by this court.

It is claimed by the appellant that the Nebraska Commission, itself, has recognized that the order in this case is inconsistent with straight-line depreciation accounting, and in proof of that fact reference is made to decision entered by the State Commission November 27, 1935, fixing the 1935 depreciation rate for appellant. A quotation from that decision is set out on page 55 of the brief. The language used by the Commissioner who wrote the opinion is not readily understandable taken out of its context. What he undoubtedly intended to convey was that in fixing the rate for 1934, the Commission did not have in mind to set aside an equal aliquot part of the service value, but sought, rather, to make such allowance as would correct excessive allowances made in past years. When he speaks of the straight-line having been broken, he refers, of course, to a graph which would represent the annual charges for depreciation. If these were excessive the graph representing them would, instead of a straight line, be a series of broken lines, rising above the horizontal co-ordinate axis.

It would be necessary in that case to continue the graph by a descending line. If what the Commission said in 1935 has any bearing upon the order made by it in 1933, it would be fairer to quote what is said in that order after the portion which is quoted in the brief on page 55. In order that the court may not be misinformed in this matter, we quote here the entire statement made by the State Commission, which we think bears out all that we have said:

THE TEST OF EXPERIENCE

"In our report to the Interstate Commerce Commission, we recommended an overall composite annual depreciation rate of 3.18%. This was based upon company's retirements for 1933. Our purpose was to prevent a further increase of balance in account for accrued depreciation. We recognized then that we were not following the straight line method of depreciation accounting, but the line had already been broken by the economic depression; inadequacy had ceased to be a factor in current operation. We now hold that the experience of a single year does not form a sound basis for estimating future depreciation rates. On the other hand, we hold that company's actual experience with retirements covering a period of time which equals or approaches to an average turnover or cycle of all depreciable property, forms a sound basis for estimating future depreciation rates.

We have such a turnover or cycle or a close approach to it in the experience of Nebraska Telephone Company from 1913 to 1920, and the experience of the Northwestern Bell Telephone Company from 1921 to 1935 for the Nebraska and South Dakota area. Our accounting department has prepared the following data from annual reports of Nebraska Telephone Company from 1913 to 1921, and from exhibit 23 submitted by respondent at our request for the Northwestern Bell Telephone Company from 1921 to 1935.

The latter has been corrected to exclude property not considered depreciable by revised Uniform System of Accounts and made effective January 1, 1933. The former has not.

Northwestern Bell Telephone Company
Nebraska-South Dakota Area
Depreciable Plant and Credits and Debits to the Depreciation Reserve
Period Year 1913 to 1934, Inclusive

Year	A Depreciable Plant	B Debits to the Depreciation Reserve	% Ratio B to A	C Credits to the Depreciation Reserve	% Ratio C to A
		Nebraska Telephone Company			
1913	$ 9,174,627.15	$ 454,343.10		$ 368,705.00	
1914	9,975,650.64	329,672.33		468,762.00	
1915	10,489,390.24	484,022.43		573,366.32	
1916	10,402,809.02	585,399.24		632,266.66	
1917	11,102,590.23	293,435.73		652,849.62	
1918	13,087,376.50	189,371.11		579,257.53	
1919	14,448,389.70	563,400.22		766,308.11	
1920	16,159,996.65	724,042.42		860,362.93	
		Northwestern Bell Telephone Company			
1921	15,721,536.67	477,781.52		821,224.76	
1922	18,614,480.14	1,015,255.66		968,354.59	
1923	19,974,816.99	347,052.93		1,037,295.04	
1924	20,543,759.75	583,932.04		1,064,408.80	
1925	21,153,610.80	620,151.18		1,097,442.83	
1926	21,587,324.44	593,860.12		1,134,247.92	
1927	22,007,618.66	630,262,41		1,209,003.05	
1928	23,146,063.37	858,965.87		1,278,809.18	
1929	24,480,092.50	1,007,787.74		1,291,668.56	
1930	26,839,154,01	1,329,518.10		1,416,571.69	
1931	28,386,967.19	1,434,331.78		1,487,006.05	
1932	29,245,988.15	874,177.91		1,443,757.39	
1933	29,108,039.48	450,048.52		1,307,314.20	
1934	29,204,412.41	460,820.23		1,319,239.34	
Total 22 Years	$424,854,694.69	$14,307,632.59		$21,773,220.57	
Average 22 Yrs.	$19,311,577.03	$650,346.93	3.37	$989,691.84	5.12

The weighted average of debits for Nebraska Telephone Company period equals 3.82% of depreciable property. The weighted average of debits for the Northwestern Bell Telephone Company period equals 3.24% of depreciable property. The weighted average for both periods equals 3.37% of depreciable property. No part of this rate is based upon the judgment of company's engineering staff. It represents the company's actual experience for 22 years. If any part of this rate is based upon judgment, it is the judgment of the management during the 22-year period, as to when retirement should be made.

To keep the investment intact we must make an allowance for 12% existing accrued depreciation. The 12% reduced to dollars equals $3,504,529. On January 1, 1913, the Company had in reserve for accrued depreciation the sum of $1,587,400, and deducting this from $3,504,529 we have $1,917,128. By dividing the last amount by 424,854,694, the total of the average amount of depreciable property by years for the 22-year period we have a rate of .45% which added to the rate of 3.37% gives us a rate of 3.82%. We, therefore, conclude that an overall composite rate of 3.82% would have been adequate for the 22-year period to pay expense of all retirements and to have kept the investment intact. This rate gives no consideration to the fact that on account of inadequacy and improvements in the art, service life will be increased in the future.

We believe that 22 years is fairly representative of a turnover or cycle period. Company's weighted average credits to depreciation reserve for this period is 5.12% of depreciable property. This would indicate an average turnover period of 19.3 years. Company's proposed rate of 4.44% would indicate an average turnover period of 22.5 years. A rate of 3.82% would indicate a turnover period of 26.2 years. The total retirements of $14,307,632 for the 22-year period do not equal or approximate the average investment of

$19,311,557 in depreciable property. This difference arises from the excessive increase in growth of investment in depreciable property from 1913 to 1932. There has not yet been an average turnover of depreciable property. It is to us conclusive evidence that company's estimate of service life in the past has been too conservative, resulting in excessive percentage rates. Until the time that the average depreciable investment equals or approximates the total retirements, it cannot be said that we have an average turnover period. The past period of excessive growth affords no basis for future estimates. If a composite rate of 3.82% should in the future be inadequate, it can be corrected by order of the Commission. Considering the excessive balance in reserve for accrued depreciation and that inadequacy will not be an active factor until lost stations have been restored, we are of the opinion and so find that an overall composite rate of 3.82% will be adequate to keep respondent's investment intact for 1935, and that respondent should apply such rates to primary accounts as will result in an overall composite for all depreciable property in Nebraska, not exceeding 3.82%."

(Above quotation commences with, includes, and continues quotation set out in appellant's brief, p. 55.)

(3) Rates to Be Based on Estimated Service Values and Service Life

Appellant, of course, insists that the provisions of Instruction 80 of the Uniform System of Accounts is applicable here. As we have pointed out, this provision does not govern, but only such provision as was left in force by the proviso in the order of the Interstate Commerce Commission of June 5, 1933, postponing the effective dates of depreciation accounting to January 1, 1935. Both that order, as well as the provisions of Depreciation Section

Circular No. 7, which was made a basis of the order of the State Commission requiring schedules of depreciation rates and data to be filed with it, provide that the depreciation rates applied by the company for its accounting shall be based upon the best estimates available of service lives and salvage values.

However, we need not insist upon any distinction as to the rules applicable here. The appellant, in compliance with the order of the State Commission, filed with it on February 28, 1934, a schedule of depreciable property and depreciation percentages for use during the year 1934, which included estimates of service life and net salvage value for each of its classes of property. These schedules were explained in detail by Mr. Granfield, the inventory and cost engineer of the appellant telephone company (R., p. 44), under whose direction they had been prepared (R., p. 45).

As an illustration of the nature of the testimony presented by Mr. Granfield, we set out below his testimony with reference to the computation of the annual depreciation charge for central office equipment. This was reflected in the schedules filed by the company in Schedule 2, sheet 3, appearing on page 12 of the record:

(By Mr. Forbes:)

Q. "You may state in your own way, Mr. Granfield, how you proceeded to find the rate of 5.2 fixed for annual depreciation of central office equipment?"

A. "The central office equipment account includes quite a variety of installations, and in developing the depreciation rate, we have studied each class of installation separately. We have taken the large common battery offices in one group, dial offices in another

group, magneto offices in another group, and so on. The manual offices, that is the large manual offices, have been studied by determining the average service life already realized for each office. To do that we found when it was first installed; how much was invested in it at that time, and we follow it through its history year by year, and record all of the charges against (fol. 138) the reserve in that office for partial displacements and all of the additions made. As a result of the additions and retirements in an office placed, for example, in 1915, some eighteen years ago, might today have an average service life of as much as seven or eight years, because new equipment represents a substantial investment, and has a short life or low age at the present time, and that offsets the longer age of the parts of the original installation that still remains. From that sort of study for each office, we determine the expectancy or the average life in relation to age. Then we get forecasts of the probable final retirements from every office, and from that determine the average length of time that these installations may be expected to live, from initial installation to final retirement, and that average overall age we call it, related to the average service life that's built up on the average in that period of time, gives us the average service life for that class of equipment.

"Similar methods are applied to other types of manual offices and the composite rate for all manual offices is developed.

"Then we have to take into account the dial offices; and the service life expected in the dial offices is a matter largely of judgment. We have retired several complete dial installations, but the dial offices that constitute the greater part of our present investment in dial offices, are different in many respects from those which have been retired, so that we have, as a matter of judgment, given them a substantially longer service life.

"Then there is also a substantial investment in toll terminal (fol. 139) and telegraph equipment. That is mostly relatively new equipment—the repeaters, terminals, telegraph equipment of various kinds, and the service life of that part of the investment is based largely on judgment, because nearly all of our investment in that type of equipment is only six or seven years old at the most. And we also have a small investment in miscellaneous portable equipment. That includes what was formerly known as the other equipment in central office account. That is such things as rolling ladders, wire chiefs' desks etc., and that was studied by what we call a turnover cycle method, when it was in a separate account, and we have used the results of that study for this portion of the central office equipment account.

"Then all of these component rates were composited on the basis of the investment as of January 1st this year, and the result was 5.2%. I didn't mention the salvage.

"The salvage is based on judgment related to our past experience. There was a time in the past when there was quite a field for reuse of large manual switchboards which were retired from service, but now there is practically no field for them, and the last several offices we have retired have netted but little salvage, so that salvage set-up is based on what seems to be the maximum that we could expect, in view of the present state of affairs. 5.2% was the composite result of the detailed treatment of each subdivision of the account and each individual study is quite a voluminous study, and the supporting data, when it is prepared, will have quite a volume of data and analysis for each subdivision of this account."

(R., pp. 89-90 and 91.)

He was then interrogated in detail as to various types of exchanges and the replacements and retirements neces-

sary, and particularly with reference to the factor of obsolescence and inadequacy, also as to the effect that adequate maintenance had upon depreciation charges (R., pp. 91 to 108).

The testimony as to central office equipment is illustrative with regard to the method used with each class of property. The studies of service life and salvage values made by the company was used as a basis, and to this was added the factor of judgment on the part of the valuation experts employed by the company.

To the testimony of the appellant's staff members was added certain testimony of the Commission, bearing upon matters to which we have adverted. (See statement.) This testimony covered: the ratio of depreciation reserve to the investment indicating excessive allowance for retirements (Exh. 2, R., pp. 191-193); evidence as to the estimated per cent condition of the exchange service property in Nebraska (Exh. 4, R., p. 195); evidence showing a marked degree in the growth of population of the communities served (Exh. 5, R., pp. 197-199), and evidence showing the loss in stations sustained by the company during the period of depression (Exh. 6, R., p. 200).

The State Commission considered the testimony of the members of appellant's engineering and accounting staff, as well as its own testimony, and applied to the same their informed judgment. It will thus be seen that the testimony was in fact based upon estimates of service life and service values, judged in the light not only of the informed judgment of the company's engineers, but also in the light of the informed judgment of the Commission.

We respectfully submit that there is nothing in the order of the Commission which indicates that there was any departure from any applicable rules of the Interstate Commerce Commission requiring percentage rates to be based upon service lives and service values.

Point 6

The order is not obnoxious to the constitutional provision guaranteeing appellant due process of law either on the ground that it requires the making of incorrect accounting entries or because it is not founded upon any evidence in the record.

(1) The Order of the Commission Does Not Require the Making of Incorrect Accounting Entries

Appellant insists, first: That the order, if enforced, would deprive appellant of the right to keep accurate books of accounts; and, second, that the order is intended to, and does, require the use by appellant in its accounts of depreciation rates which were less than the true rates for the sole purpose of reducing the balance in its depreciation reserve accounts.

Appellant's contention is based upon a fundamental fallacy. It assumes, first: That it is possible to ascertain with accuracy and precision the amount necessary to maintain an adequate depreciation reserve; second, that appellant has so determined the amount; and, third, that any change or alteration of that amount would produce an inaccurate and incorrect rate of depreciation.

It is then argued that to require appellant to use such changed or altered amount for the purpose of bookkeeping

or reporting to Commissions, state or federal, would be to require it to make false entries and keep inaccurate accounts.

We respectfully submit that if the State Commission has jurisdiction, as we contend, and if, after notice and hearing (if they be required) it has entered an order altering and correcting the amounts which appellant should be permitted to credit to its depreciation reserve, such amounts and such entries cannot justly be termed false and untrue.

In addition to this, as we have previously pointed out in our discussion above, under Point 3, there is nothing in the Uniform System of Accounts for Telephone Companies, First Revised Issue, which would prevent the appellant from setting up an additional reserve representing the difference between the amount of the depreciation reserve it considered necessary and the amount prescribed by the Commission, and carrying such account on its books until it was determined by the experience of the company whether the Commission had erred, or whether the Company was itself in error.

The argument of appellant seems to us rather a labored effort for the purpose of showing that appellant has in some way been affected in its property rights, a matter which we discussed fully under Point 3, above. We are satisfied that the appellant has sustained no such injury.

(2) The Order Is Founded Upon Sufficient Evidence

The order does not deny to appellant due process of law in that it is not founded upon any evidence in the record.

(a) Legislative Enactment Should Not Require Support of Evidence

The appeal in this case is, as we have pointed out, based on a federal statute under which the order of the Commission is construed as a statute of the state. If such is its nature and character (and such it would seem to be under the rule laid down by this court in *Prentiss* v. *Atlantic Coast Line R. R. Co.*, 211 U. S. 210) it should be tested by the same test as is, for example, applied to a municipal ordinance,—which need not rest on evidence, but is sufficient if it be reasonable and not otherwise unlawful in its operation. See cases examined under Point 2, subd. (b), supra.

(b) The Order of the Commission Is, However, Based Upon Sufficient and Satisfactory Evidence

The contention of appellant seems to be that the Commission looked solely to the discrepancy between the per cent condition of the company's property as reflected in Exhibit 4 (the accuracy of which is not challenged and which shows an estimated per cent condition in 1933 of 89%) and the ratio of the depreciation reserve to the plant investment, which, as disclosed by Exhibit 3, was on December 31, 1932, 24.24%. It is argued that this differential has no significance, and that it was improper for the Commission to take it into account.

In this position the appellant is at variance with the conclusions of the court in the case of *Lindheimer* v. *Illinois Bell Telephone Company*, 292 U. S. 151. In that case this court had to do with certain depreciation charges which had been fixed by the State Commission and which had been drawn in question in the lower federal court. In

testing the reasonableness of the allowances for depreciation reserve, this court compared existing depreciation in the property with the amount set up for depreciation reserve. It was noted that, for example, in 1931, existing depreciation amounted to $15,828,000.00 as compared with a reserve for depreciation of $48,362,000.00. The telephone company there, as in this case, strenuously objected that there was no proper relationship between existing depreciation and the depreciation reserve. Much the same arguments were made as in this case, as is apparent from an examination of the opinion (pp. 171-172). The court also considered in the *Lindheimer* case the fact that larger amounts had been expended for current maintenance than had been set off for depreciation reserve, the amounts being in the year 1931 as follows:

For current maintenance.....	$10,842,053.00
Depreciation	8,133,000.00

(p. 174)

In the instant case, there was a comparison of the amounts expended for replacement from the depreciation reserve and for maintenance. For example, for the year 1932, the amount expended for replacements and charged to the depreciation reserve amounted to $4,277,488.36 as against an amount expended for maintenance in the sum of $5,253,887.56 (R., p. 26). This court said, in the *Lindheimer* case:

> "In the light of the evidence as to the expenditures for current maintenance and the proved condition of the property—in the face of the disparity between the actual extent of depreciation, as ascertained according to the comprehensive standards used by the Company's witnesses, and the amount of the depreciation reserve—it cannot be said that the Company has es-

tablished that the reserve merely represents the consumption of capital in the service rendered. Rather it appears that the depreciation reserve to a large extent represents provision for capital additions, over and above the amount required to cover capital consumption. This excess in the balance of the reserve account has been built up by excessive annual allowances for depreciation charged to operating expenses."

There are also illustrative comparisons contained in tables set out in the concurring opinion of Mr. Justice Butler in the *Lindheimer* case (pp. 178 to 180), which afford comparative data similar to that referred to in the majority opinion in the *Lindheimer* case, and also to the data set out in the opinion or report of the Nebraska State Railway Commission, antecedent to the order which is drawn in question in this case. It would seem that the Commission was fully justified in its conclusion upon the evidence before it, that the depreciation reserve was excessive in amount. This being true, the Commission had the undoubted right to consider that fact in establishing a proper rate of depreciation.

We have previously pointed out that the action of the Commission in its order was based, first, upon schedules of the company showing their estimates of service life and service value of depreciable property (R., p. 10 to p. 17). Added to this was the testimony of Mr. Granfield, stating how these estimates had been made, and showing the degree to which judgment of himself and his subordinate associates had entered into them. Mr. Granfield was examined, amongst other things, with regard to growth or lack of growth as affecting the element of inadequacy, and also with regard to the progress which had been made in the development of telephone plants as bearing upon the ques-

tion of future obsolescence, these all being matters into which the element of judgment must necessarily enter to a large degree. Mr. Granfield stated, with regard to the matter of growth or lack of growth of the company as affecting the element of inadequacy:

> "Related to the amount of investment, it may be that the demands on the reserve in the last ten years were somewhat more than would be expected in a normal decade * * *." (R., p. 53.)

He admitted that it was generally true that towns in Nebraska from 2,500 to 5,000 where the company owned exchanges had just about experienced the growth that they will have for a long time (R., p. 54). He admitted that the towns in Nebraska had not grown in the last five or six years, and he knew of nothing that would make him expect that they would (R., p. 54). He made a somewhat grudging admission that the ordinary course of development of the telephone plants in Nebraska, as they are maintained at the present time, has gone about as far as might be expected, saying:

> Q. "In the ordinary course of development of the telephone plant, where the switchboard is operating magneto, perhaps the farm lines are grounded, and the town portion of the exchange lines are metallic the exchange has gone on, the farm lines have been made metallic, the town has been cabled, the switchboard been made common battery, isn't that about the maximum development as far as we know now in towns around twenty-five hundred to five thousand inhabitants?"
>
> A. "When that has all been done, that is about as far as we expect most of them to go now. However, there are constantly being made new developments in service. It is now possible to handle even grounded lines through automatic switching equipment, where-

as even two or three years ago it was impractical to use automatic switching equipment where any grounded lines were involved, and that precluded a change being made that might otherwise have been desirable. Also, the extent to which grounded lines are used is still considerable in Nebraska." (R., p. 55.)

He admitted that he knew of no changes in the art which might make it necessary to use a 25 million dollar reserve immediately (R., pp. 58-59).

In addition to this, it appears throughout the entire record that as to each class of telephone property the estimated service lives and service values were based not only upon studies of the experience of the company but also upon the judgment of its valuation engineers. In some instances the element of judgment bore a very large part of the estimates of service life. For instance, with regard to the service life of dial equipment, the estimate was based largely on judgment because, as stated by Mr. Granfield, "We have not had any of our own dial installations long enough to retire them, so this figure is based on the judgment as to the average service life which will be realized when the dial installations are retired" (R., p. 92).

The Commission, composed as it is of men of experience in utility affairs, must be presumed to have some knowledge of matters with which they have frequent occasion to deal. To the facts placed before them by the schedules, estimates of service life and service values of the company, as explained by the company's staff, together with other facts appearing from statistics collected under their direction by their own accountant from data and reports in their office, the Commission employed its informed judgment to revise the judgment of the company engineers, not

for the purpose of arbitrarily reducing the estimates for depreciation reserve for the year 1934, but in order that the reserve might be made truly to reflect the amount necessary to preserve the plant investment of the appellant telephone company intact. We submit that the evidence is fully sufficient and satisfactory.

CONCLUSION

In conclusion, since, *First,* the State Commission has not trenched upon any matters committed exclusively to federal control under the Interstate Commerce clause of the Constitution, and, *Second,* appellant has not been denied due process of law nor equal protection of the law by the order of the Commission, the appeal should be dismissed.

Respectfully submitted,

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EDWIN VAIL,
Assistant Attorney General,
Counsel for Appellee.

JOHN E. BENTON, *of Counsel.*

FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

No. 350

NORTHWESTERN BELL TELEPHONE COMPANY, *Appellants*,

v.

NEBRASKA STATE RAILWAY COMMISSION, *Appellee*.

MOTION OF THE NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE.

BRIEF OF SAID NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS PRESENTED WITH SAID MOTION.

CLYDE S. BAILEY,
JOHN E. BENTON,
Counsel for said Association.

EDWIN VAIL,
Of Counsel.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

No. 350

NORTHWESTERN BELL TELEPHONE COMPANY, *Appellants*,

v.

NEBRASKA STATE RAILWAY COMMISSION, *Appellee*.

MOTION OF THE NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS FOR LEAVE TO FILE A BRIEF AS AMICUS CURIAE.

The National Association of Railroad and Utilities Commissioners respectfully represents to the court that it is a voluntary Association which includes in its membership the members of the regulatory commissions of the several States of the United States except the States of Delaware and New York. Said Association further represents that most of said commissions are vested with power to prescribe the accounts of public service corporations subject to their jurisdiction by administrative action, and that many of said commissions likewise are vested with power to pre-

scribe the depreciation charges of such public service companies, to be observed in the keeping of accounts and the making of reports required by State law for State purposes.

Said Association further represents that, by reason of the facts aforesaid, said regulatory commissions, and said Association, as an agency of the same, have an interest in this case; and that said Association desires to file a brief herein, in support of the validity of the order of the State Railway Commission of Nebraska, the enforcement of which is sought to be enjoined.

Wherefore said Association respectfully moves this honorable court that it be granted leave to file a brief herein as *amicus curiae*.

CLYDE S. BAILEY,
JOHN E. BENTON,
Counsel for said Association.

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No. 350

NORTHWESTERN BELL TELEPHONE COMPANY, *Appellants*,

v.

NEBRASKA STATE RAILWAY COMMISSION, *Appellee*.

BRIEF OF THE NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS AMICUS CURIAE.

PRELIMINARY STATEMENT.

This brief is filed on behalf of the National Association of Railroad and Utilities Commissioners, appearing by leave of court as *amicus curiae*. Said Association embraces within its membership the members of the railroad commissions, public service commissions and other regulatory commissions and boards of the several States of the United States, except the States of Delaware and New York. Its interest in this case, on behalf of the State commissions and boards represented in its membership, hereafter referred to collectively as State commissions, is to avoid the destruction of the jurisdiction of such commissions over the accounts and accounting practices of telephone companies which might result from a judgment of this court sustaining the contentions of the appellant.

STATEMENT OF THE CASE.

Reference is made to the statement of the case contained in the brief of the appellee, and that statement is adopted for the purposes of this brief.

SUMMARY OF ARGUMENT.

(1). Reports of public service companies to state governments, and accounts prescribed by state law to enable such reports to be made, are means and instrumentalities of state government not subject to destruction by Congress.

(2). The jurisdiction of the Nebraska Commission has not been destroyed or suspended by any exercise of paramount federal authority.

(a). The Power to Prescribe Depreciation Charges of Telephone Companies Originally Granted to the Interstate Commerce Commission and now vested in the Federal Communications Commission has Never Been Exercised, and State Jurisdiction over such Charges Continues Unaffected.

(b). The Difficulty of Determining Proper Depreciation Charges, Which Led the Interstate Commerce Commission to Undertake Substitute Short-Cut Methods.

(c). To Expedite the Beginning of Federal Depreciation Accounting the Interstate Commerce Commission Adopted Short-Cut Methods in Temporary Substitution for Compliance with the Statute.

(d). The First Short-Cut Method Planned by the Commission.

(e). The Second Short-Cut Method Adopted by the Commission, Under Which Action was Taken which is Relied Upon by the Appellant.

(f). The Interstate Commerce Commission Could Not Delegate Power to the Telephone Companies to Prescribe Their Own Depreciation Rates and Thereby Exempt Such Companies from the Regulation of the States.

(g). The contention Now Presented by the Appellant Was Overruled in the Illinois Bell Telephone Case.

(h). The Requirement of the Order That the Plaintiff Should Keep Accounts Showing Depreciation at the Prescribed Rate Upon All of Its Depreciable Property in Nebraska Did Not Exceed the Jurisdiction of the Nebraska Commission.

(i). The Appellant Apparently Recognizes That No Valid Action Was Taken Under the Grant of Power to the Interstate Commerce Commission to Prescribe Depreciation Rates.

(j). There is no conflict between the Nebraska Order and the Uniform System of Accounts for Telephone Companies Prescribed by the Interstate Commerce Commission, and now in effect.

(3). The order of the Nebraska Commission was legislative in character and, in the absence of requirement therefor in the Nebraska law, no hearing was necessary preliminary to the making of the same.

ARGUMENT.

(1). Reports of public service companies to state governments, and accounts prescribed by state law to enable such reports to be made, are means and instrumentalities of state government not subject to destruction by Congress.

The appellant contends that the Nebraska Commission was without jurisdiction to make the order here involved because Section 20(5) of the Interstate Commerce Act, which applied to telephone companies when the Nebraska order was made, grants to the Interstate Commerce Commission power to prescribe accounts and depreciation charges for carriers subject to the Act, and further makes it "unlawful for such carriers to keep any other accounts, records or memoranda than those prescribed or approved by the Commission."*

*See footnote on page 36 of this brief for text of Section 20(5).

In support of its contention that the Nebraska Commission was without jurisdiction to make the order involved in this proceeding, the appellant relies upon *Interstate Commerce Commission* v. *Goodrich Transit Company,* (228 U. S. 194) in which case this court sustained an order of the Interstate Commerce Commission requiring an interstate carrier to keep accounts covering all of the business of the carrier, including that which was intrastate.

The case just referred to, however, falls far short of sustaining the contention that Congress may directly, or through a regulatory agency created by it, disable a State government from requiring companies engaged in intrastate commerce within such State to keep such accounts, and to render such reports thereon, as are necessary for the governmental purposes of the State.

Accounts are required to be kept, and reports based thereon to be made, by public utilities to serve the purposes of government,—to acquaint regulatory commissions with the extent of the property of companies subject to their jurisdiction, and to give such commissions dependable information as to the operating revenues and the operating expenses of such companies; and also for the information of taxing officials; and for the information of those officials who control the issues of corporate securities and administer the laws which regulate the sale of such securities.

If a State is prevented from prescribing accounts which will supply the information which these officials need, it is crippled or prevented from performing the functions of government.

No such results follow from the application of the now familiar rule which permits the Federal government to establish the level of intrastate railroad rates when found to be necessary for the protection of interstate commerce.

In the case of such application the rights of individuals are affected, but the means are not denied the State whereby it is enabled to levy proper taxes for its maintenance, to

establish proper regulations for the government of public utilities in their services and charges, and otherwise to protect the interests of citizens of the State.

The same principle should apply with relation to State prescribed accounts and reports, necessary for the use of State governments, which prevents the Federal government from taxing the bonds of States and municipalities, or the income therefrom, *Pollock* v. *Farmers' Loan and Trust Company*, 157 U. S. 427, 586; or from taxing the salary of a State official, *Buffington* v. *Day*, 78 U. S. 113.

In *Buffington* v. *Day*, just cited, the general rule was expressed by this court as follows:

> "The General Government, and the States, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres. The former, in its appropriate sphere, is supreme: but the States within the limits of their powers not granted, or, in the language of the 10th Amendment, 'reserved,' are as independent of the General Government as that government within its sphere is independent of the States. * * * Such being the separate and independent condition of the States in our complex system, as recognized by the Constitution, and the existence of which is so indispensable, that, without them, the General Government itself would disappear from the family of nations, it would seem to follow, as a reasonable, if not a necessary consequence, that the means and instrumentalities employed for carrying on the operation of their governments for preserving their existence, and fulfilling the high and responsible duties assigned to them in the Constitution, should be left free and unimpaired; should not be liable to be crippled, much less defeated by the taxing power of another government, which power acknowledges no limits but the will of the legislative body imposing the tax. * * * It is admitted that there is no express provision in the Constitution that prohibits the General Government from taxing the means and instrumentalities of the States, nor is

there any prohibiting the States from taxing the means and instrumentalities of that government. In both cases the exemption rests upon necessary implication, and is upheld by the great law of self preservation; as any government, whose means employed in conducting its operations, if subject to the control of another and distinct government, can exist only at the mercy of that government." (78 U. S. 113)

In *Ambrosini* v. *United States,* 187 U. S. 1, the principle was applied to bonds required by the law of Illinois to be given by licensees as prerequisites to the issuance of liquor licenses. It was held that its bonds were instrumentalities of the State government and not subject to the requirements of the Federal revenue law. In its opinion the court said:

"The act and the ordinance required these bonds to be given as prerequisites to the issue of licenses permitting the sale. * * * The granting of the licenses was the exercise of a strictly governmental function, and the giving of the bonds was part of the same transaction. To tax the license would be to impair the efficiency of state and municipal action on the subject and assumes the power to suppress such action. And considering license and bond together, taxation of the bond involves the same consequences. In themselves the bonds were not mere incidents of the regulation of the traffic, but essential safeguards against its evils, and governmental instrumentalities of state and of city, as authorized by the state, to insure the public welfare in the conducts of the business, although the business itself was not governmental. They were not mere individual undertakings to secure a personal privilege as suggested by the court below, but means for the preservation of the peace, the health, and the safety of the community in compelling strict observance of the law, and remedying injurious results.

"The general principle is that, as the means and instrumentalities employed by the general government to carry into operation the powers granted to it are exempt from taxation by the states, so are those of the

> states exempt from taxation by the general government. It rests on the law of self-preservation, for any government whose means employed in conducting its strictly governmental operations are subject to the control of another and distinct government exists only at the mercy of the latter." (187 U. S. 1, 6.)

We point out that the keeping of accounts prescribed by State law, and the making of reports based thereon to State governments in no way impede the procurement by the Federal government of whatever information it may require for its own governmental purposes. If the requirements of the two governments differ, such difference may cause additional expense to regulated utilities, but so does the keeping of any system of accounts prescribed by government, which requires the compiling of information additional to that which is necessary for the purposes of the accounting company.

The Federal Power Act explicitly preserves the right of State governments to require accounts different from those prescribed by the Federal Power Commission. Section 301(a), which empowers the Federal Power Commission to prescribe accounts, contains the following proviso:

> "*Provided, however,* That nothing in this Act shall relieve any public utility from keeping any accounts, memoranda, or records which such public utility may be required to keep by or under authority of the laws of any State."

In this connection we point out that while the Communications Act of 1934 contains, in Section 220, provisions similar to those of the Interstate Commerce Act, upon which the appellant relies, paragraph (j) of said Act recognizes that the powers of State commissions with respect to accounting have not been terminated. That paragraph is as follows:

> "(j) The Commission shall investigate and report to Congress as to the need for legislation to define fur-

ther or harmonize the powers of the Commission and of State commissions with respect to matters to which this section relates."

Paragraph (l) of the same Section also provides:

"(i) The Commission, before prescribing any requirements as to accounts, records or memoranda, shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views, and shall receive and consider such views and recommendations."*

*That the cooperation provided for in this paragraph of the statute may be expected to operate to prevent the imposition of diverse accounting requirements is indicated by the experience thus far thereunder, reflected in a resolution adopted by the National Association of Railroad and Utilities Commissioners. This resolution is set forth in the published proceedings of said Association, as follows:

WHEREAS, The Interstate Commerce Commission, while vested with jurisdiction over the accounts of telephone companies engaged in interstate commerce, prescribed a system of accounts for telephone companies, which system was also prescribed or approved for use in various States as the basis for reports to the respective State regulatory commissions; and

WHEREAS, Said Interstate Commerce Commission thereafter prescribed a revised system of accounts for telephone companies, based upon the aforesaid system, to be known as "Uniform System of Accounts for Telephone Companies," which system became effective January 1, 1933; and

WHEREAS, Various State regulatory commissions prior to the taking effect of the said uniform system of accounts protested against various provisions contained therein and requested amendment of the same; and

WHEREAS, After a hearing upon said protests following the enactment of the Communications Commission Act of 1934, but before the same took effect, the Interstate Commerce Commission in its docket No. 25705 filed a report dealing with said protests; and

WHEREAS, Following the organization of the Federal Communications Commission, said Commission, by order No. 7 of its Telephone Division, provided that the State regulatory commissions and other interested parties should have until October 1, 1934, to file exceptions and objections to said report of the Interstate Commerce Commission, which time upon request of representatives of this Association was later extended until November 1, 1934; and

WHEREAS, Exceptions and objections were prepared by the accounting representatives of various State regulatory commissions, working together, which were distributed to all the commissions of the States represented in this Association, and were generally approved and filed on behalf of State regulatory commissions represented in this Association; and

WHEREAS, Said exceptions and objections were also considered by a conference of representatives of the various State commissions held at Washington, D. C., on the day preceding the 1934 convention of this Association and were approved by said conference; and

WHEREAS, At a hearing thereafter held before the Telephone Division of said Federal Communications Commission, said exceptions and objections were sup-

In view of the grave constitutional question which will be presented, if the language of Section 20(5) forbidding the keeping of other accounts than those prescribed by the Interstate Commerce Commission (now found also in the Communications Act, Section 220(g)) is to be construed as prohibiting companies from conforming to state laws, respecting accounts, the same should be construed as designed only to apply to accounting requirements to be kept as a basis for reports to be made to a Federal Commission, and not as intended to prevent compliance with State laws.

However, we believe that the Court will not find it necessary to determine whether Congress has the constitutional power to prevent public utilities from complying with State laws as respect accounts and reports necessary for State governmental purposes, nor the scope of the jurisdiction respecting accounts, which Congress undertook to vest in

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ported by the General Solicitor of this Association under instructions from the commissions of forty-two States; and

WHEREAS, Following said hearing the Federal Communications Commission, through its Telephone Division, called a conference of representations of State commissions and of telephone utilities for discussion and consideration of the provisions to be contained in said proposed Uniform System of Accounts, at which conference the State commissions were represented by officers of this Association and by the accountants who had prepared said exceptions and objections; and

WHEREAS, Said exceptions and objections were thereupon fully considered and the Uniform System of Accounts for Telephone Companies theretofore promulgated by the Interstate Commerce Commission was thereupon amended and revised; and

WHEREAS, The accounting representatives of the State commissions represented in this Association participating in said conference concurred in such amendments and revision; and

WHEREAS, Said revised Uniform System of Accounts has since been promulgated by the Federal Communications Commission through its Telephone Division by its order dated June 19, 1935, to be known and designated as "Uniform System of Accounts for Telephone Companies, issue of June 19, 1935, effective January 1, 1936"; and

WHEREAS, It is highly desirable that accounting regulations proscribed for the use of companies subject to the jurisdiction of both Federal and State authorities shall be prepared in cooperative conferences and shall be prescribed by both Federal and State authorities whenever that shall be possible, so that conflicting and diverse requirements may be avoided; Therefore be it

RESOLVED, That this Association recommends to the several State commissions represented in this Association, which exercise jurisdiction over the accounts of telephone companies that they respectively adopt and prescribe for State application the aforesaid Uniform System of Accounts for Telephone Companies, prescribed as aforesaid by Federal Communications Commission. (Proceedings, 47th Annual Convention, National Association of Railroad and Utilities Commissioners, Page 480-483)

the Interstate Commerce Commission by said Section 20(5). We believe that the Court will not come to these questions, because it will find that the order here involved is in no way in conflict with any regulation imposed by Congress or by its authority. It is to this proposition that the remainder of our argument upon the question of jurisdiction will be directed.

(2). The jurisdiction of the Nebraska Commission has not been destroyed or suspended by any exercise of paramount federal authority.

The Power to Prescribe Depreciation Charges of Telephone Companies Originally Granted to the Interstate Commerce Commission and Now Vested in the Federal Communications Commission Has Never Been Exercised, and State Jurisdiction Over Such Charges Continues Unaffected.

The statutory provisions upon which the appellant relies are found in Section 20 of the Interstate Commerce Act, which provides as follows:

> "Sec. 20. (1) That the Commission is hereby authorized to require annual reports from all common carriers subject to the provisions of this Act, * * * and the Commission may, in its discretion, for the purposes of enabling it the better to carry out the purposes of this Act, prescribe a period of time within which all common carriers subject to the provisions of this Act shall have, as near as may be, a uniform system of accounts, and the manner in which such accounts shall be kept. * * *
>
> "(5) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys. The Commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of property for

which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this Act shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. * * * and it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed or approved by the Commission. * * *"

The direction by Congress was that *the Commission itself* should prescribe "as soon as practicable" depreciation rates for the several classes of depreciable property of the companies subject to its jurisdiction; and the statute also provided that, when the Commission should have obeyed the mandate of the statute, the companies affected were required to charge to operating expenses amounts for depreciation conforming to the Commission's order. Until the Commission should establish depreciation rates found proper by it, however, we maintain that the intent of the statute was that the companies subject to the Commission's jurisdiction, should continue free from Federal control in the matter of depreciation accounting. The only restrictions provided in the statute are that no carrier, subject to the Act, shall charge to operating expense "any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission," and that no such

company shall "include in any sum under its operating or other expenses" any amount which is elsewhere carried as a depreciation charge.

These provisions as to depreciation were enacted in 1920. It can not be supposed that the Congress was ignorant of the difficulties which would confront the Commission in the performance of the duties imposed upon it. It was recognized that a considerable time would be required before the Commission could act. The Congress accordingly directed the Commission to prescribe depreciation rates, not immediately, but "as soon as practicable."

It can not be supposed that it was the intent of Congress that no depreciation charges whatever should be made by carriers pending the time when the Commission should be prepared to act. Neither can it be supposed that it was the intention of Congress, even if it had the power, to leave companies engaged both in interstate commerce and in intrastate commerce altogether free from regulation by the States during the years which might intervene between the enactment of the statute and the prescription of depreciation rates by the Federal Commission.

It must accordingly have been the intent of Congress that the orders of the Commission should become effective when made; and that until the promulgation of such orders, the companies to which they were to apply should be left unaffected by the statute. If the statute be so construed, no question of conflict between Federal and State requirements can arise pending action by the Federal commission in conformity with the Congressional direction.

The importance of the point here involved is obvious. The appellant's construction of the statute, if constitutional, would result in the removal of all regulation of depreciation charges for an indefinite time. Our construction would leave State regulation unaffected, at least until the Federal Commission should exercise the power conferred upon it.

The provisions of Section 20(5) of the Interstate Commerce Act were enacted in 1920, as a part of the Transportation Act.

The order of the Interstate Commerce Commission in No. 14,700 *Depreciation Charges of Telephone Companies*, I. C. C. No. 14,700, 177 I. C. C. 351, did not prescribe telephone depreciation rates, and did not purport to do so. It merely called upon the Telephone companies to submit estimated rates of depreciation upon certain classes of property, specified by the Commission, to the State commissions on or before September 1, 1932, together with sworn statements as to the bases and methods used in the preparation of such estimates. This order was made on July 28, 1931. By subsequent orders the effective date of that order was twice postponed by the Interstate Commerce Commission. The last order of that Commission provided that the data required to be filed with the State commissions should be so filed on August 1, 1934 and that the depreciation accounting contemplated by the order should begin on January 1, 1935. We will later in this brief discuss the plan and purpose of this order—we now proceed to point out that, in so far as it related to the institution of depreciation accounting, it never took effect.

After the organization of the Federal Communications Commission, that Commission made the following orders respecting said order of the Interstate Commerce Commission of July 28, 1931, in said No. 14,700—

FEDERAL COMMUNICATIONS COMMISSION
Telephone Division

Order No. 10-A
Docket No. 2552

December 13, 1934.

Commissioners Walker, Chairman, Case and Sykes:

In a regular meeting of the Telephone Division of the Federal Communications Commission, December 13, 1934:

The Telephone Division having under consideration the orders and memoranda heretofore issued by the Interstate Commerce Commission in its Docket No. 14,700, Depreciation Charges of Telephone Companies, effective January 1, 1935, and the hearing and argument thereon:

IT IS ORDERED, That said orders of the Interstate Commerce Commission be, and they are hereby amended as follows:

(a) By changing the effective date of said order of July 28, 1931, applicable to Class A telephone companies, from January 1, 1935, to January 1, 1936.

(b) By extending to May 1, 1935, the time within which the State Commissions, if they so desire, may submit original recommendations to this Commission for its consideration in issuing any orders specifying the composite annual percentage rates to be used by Class A telephone companies.

Provided, That the estimates of composite percentage rates submitted by telephone companies to the State Commissions and to this Commission are for the information of the several Commissions, but shall not be deemed to be prima facie correct.

Provided further, That nothing in the foregoing shall be construed as relieving telephone companies from accounting for depreciation by the application to the primary plant account of composite annual percentage rates based upon the best estimates available of service lives and salvage values, as required by the Uniform System of Accounts for Telephone Companies, (First Revised Issue, 1933), unless and until further ordered by this Commission in accordance with the foregoing order.

By the Commission, Telephone Division.

HERBERT L. PETTEY,
Secretary.

(Seal)

FEDERAL COMMUNICATIONS COMMISSION
Telephone Division

Order No. 10-B
Docket No. 2552

Commissioners Walker, Chairman, Brown and Case:

At a regular meeting of the Telephone Division of the Federal Communications Commission, May 1, 1935:

The Telephone Division, having under consideration the records and orders in Interstate Commerce Commission Docket No. 14,700, Depreciation Charges of Telephone Companies, and Federal Communications Commission Docket No. 2552, Depreciation Charges of Telephone Companies:

It is Ordered, That the effective dates of the orders heretofore prescribed by the Interstate Commerce Commission and the Federal Communications Commission in these proceedings be, and they are hereby, indefinitely postponed.

By the Commission, Telephone Division.

HERBERT L. PETTEY,
(Seal) Secretary.

It thus appears that if the effect of the provisions of Section 20(5) of the Interstate Commerce Act, enacted in 1920, was to exclude State regulation of depreciation accounting, the result has been to leave telephone companies free from public regulation of their depreciation charges for a period of more than 15 years already passed, and until some time in the indefinite future when the Communications Commission may be prepared to prescribe depreciation rates.

The Difficulty of Determining Proper Depreciation Charges, Which Led the Interstate Commerce Commission to Undertake Substitute Short-Cut Methods.

The explanation of this long delay by the Federal regulatory commissions in carrying out the directions of Congress is undoubtedly to be found in the difficulty of the task imposed by the statute. In a report in said *Depreciation*

Charges of Telephone Companies, I. C. C. 14,700, made on November 2, 1926, the Interstate Commerce Commission said:

> "All parties to this proceeding concede that uniform rates of depreciation can not be established for all telephone companies. *There is entire agreement that rates of depreciation for the same classes of property differ materially, dependent upon the conditions under which the particular company operates, and that if we are to prescribe rates of depreciation, as the statute contemplates, a careful study must be made of the situation of each individual company.* Nor, so far as we are aware, has any exception been taken to the assertion of the committee representing the National Association of Railway and Utilities Commissioners that the great bulk of telephone business consists of intrastate local community service; that the interstate service is largely toll service; and that it constitutes an insignificant fraction of the total business. These being the facts, and disregarding for the moment the proper interpretation of the law we are called upon to administer, it is obvious that *the determination of rates of depreciation for the various classes of telephone property is a task which could more appropriately, conveniently, and economically be carried on by the State commissions than by us.* It becomes necessary to consider, however, whether under the law as it now stands it is legally possible to leave this task wholly to the State commissions. * * * (Italics ours)
>
> "So far as the class D telephone companies are concerned it may be conceded that the prescription of depreciation requirements by us is impracticable, for the same reasons that we have refrained from requiring such companies to conform to our uniform system of accounts. So far as the companies in classes A, B and C are concerned, however, we are unable to conclude that the prescription of depreciation requirements by us, although involving much time and expense, is *impracticable.* Unless and until the provisions of paragraph (5) of section 20 are changed by Congress, therefore, we feel that we must endeavor to enforce them in the case of such companies. * * *" (118 I. C. C. 295, 332, 333)

The years of delay which have followed the conclusion thus announced bear additional testimony to the difficulty of the enormous task which the Commission felt imposed upon it by the law.

In determining whether Congress could have intended that telephone companies should be set free from State regulation of their depreciation charges during the investigation which would be necessary, before the Federal commission could prescribe such charges, regard must be had not only to the length of time which such investigation necessarily would involve, but also to the fact, recited by the Interstate Commerce Commission in the language just quoted, that "the great bulk of telephone business consists of intrastate local community service" and that interstate service "constitutes an insignificant fraction of the total business."

The necessity for public regulation of depreciation charges was demonstrated by the decision of this court in *Lindheimer* v. *Illinois Bell Telephone Company*, 292 U. S. 150, in which case it appeared that the telephone utility involved in that case, over a long term of years, had been charging to operating expense, for depreciation, amounts greatly in excess of the amounts necessary to cover depreciation actually accrued. In that case the court very clearly stated what should be aimed at in the making of depreciation charges, and the misuse to which such charges may be put, as follows:

> "Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. * * * According to the practice of the Company, the depreciation reserve is not held as a separate fund but is invested in plant and equipment. As the allowances for depreciation, credited to the depreciation reserve account, are charged to operating expenses, the depreciation reserve invested in the property thus represents, at a given time the amount of the investment which has been made out of the proceeds of telephone rates for the ostensible purpose of replacing capital

consumed. If the predictions of service life were entirely accurate and retirements were made when and as these predictions were precisely fulfilled, the depreciation reserve would represent the consumption of capital on a cost basis, according to the method which spreads that loss over the respective service periods. But if the amounts charged to operating expenses and credited to the account for depreciation reserve are excessive, to that extent subscribers for the telephone service are required to provide in effect capital contributions, not to make good losses incurred by the utility in the service rendered and thus to keep its investment unimpaired, but to secure additional plant and equipment upon which the utility expects a return." (292 U. S. 167, 168, 169)

In the case now before this Court it appeared at the hearing before the Nebraska Commission, before the order involved in this case was made, that the appellant had accumulated depreciation reserves of 25.99 per cent whereas, according to the appellant's own estimate its telephone properties were in 88 per cent condition (Exhibits 3, Rec. 191, and Exhibit 4, Rec. 196).

The Congress must have had knowledge of these practices of telephone companies. The enactment of Section 20(5) shows that it recognized the danger of the misuse of depreciation charges. It is not to be lightly supposed that it intended to destroy the power of State regulation, at least without providing forthwith a substitute.

To Expedite the Beginning of Federal Depreciation Accounting the Interstate Commerce Commission Adopted Short-Cut Methods in Temporary Substitution for Compliance with the Statute.

The Interstate Commerce Commission never either determined or promulgated rates of depreciation to be observed by telephone companies. It did, however, take action hereinbefore referred to, under which it intended that telephone utilities should begin to make depreciation charges prior

to determination by the Interstate Commerce Commission of the propriety of such charges, leaving such determination to be made thereafter in individual cases, as complaints presented to the Commission should compel, and as the Commission might find itself able to reach conclusions. In order to discuss clearly the present case, it is necessary to review the action of the Interstate Commerce Commission in this matter.

Recognizing the difficulty of the task with which it was confronted, and the great length of time which would be required properly to determine depreciation rates to be prescribed for the great number of utilities subject to its jurisdiction, the Interstate Commerce Commission undertook to bridge the gap by two short cut methods, one of which it never followed to the contemplated end, and the other of which resulted in the order here relied upon by the appellant. This latter short cut was wholly without warrant of law, as we shall point out when we come to a discussion of the same.

The Commission took these two separate actions at different times. The first never resulted in the promulgation of any order or orders prescribing depreciation rates, but was preparatory thereto. The second was the inclusion in the Uniform System of Accounts for Telephone Companies of certain instructions concerning depreciation. Those instructions are what the appellant especially relies upon in this case. These two short cuts will be now discussed.

The First Short-Cut Method Planned by the Commission.

In its first report *In Depreciation Charges of Telephone Companies,* 118 I. C. C. 295, in 1926, from which quotation has already been made, the Commission stated the difficulty of the situation with which it was faced, and the course which it then proposed to pursue as follows:

> "Upon one proposition all parties are agreed, and that is that the service lives of the same kind of prop-

erty vary widely in different companies. It is impossible to lay down any general rule which will apply in the case of all companies or even in the case of a particular class of companies, owing to the different conditions which surround the use of the property in each individual case. Our depreciation section, in the case of both steam railroad companies and telephone companies, recommended that the yearly percentages of depreciation (which are dependent wholly upon prospective service lives) should be ascertained in the first instance by a formula. In the case of telephone companies this formula was as follows:

'After the service life of each class of property has been estimated, ascertain by classes of property the total amount of actual retirements and the total amount of salvage for a period immediately preceding the effective date of these regulations which shall contain the same number of years as is embraced within the estimated service life of each class. Obtain therefrom the average amount of annual retirements and the average amount of annual salvage by classes.'

'The ratio which the average annual amount of retirements less the average annual amount of salvage, bears to the original or estimated cost of the class of property affected plus the cost of additions and betterments thereto, shall be the percentage of depreciation applicable to that class of property for the first year subsequent to the effective date of these regulations.' * * *

"In effect this formula is nothing more nor less than an attempt to base prospective service life for the future solely upon the experience of the past. This, it seems to us, constitutes its great defect. In the first place, it is doubtful whether many companies possess the records which would make possible the application of the formula, particularly in the case of classes of property having long service lives. In the second place, and this is a still more important consideration, it is by no means an inevitable conclusion that service lives in the future will be the same as they have been in the past. Not only do types of property change in con-

struction and character, but the conditions under which they are used change, often very radically. For example, it was pointed out in these proceedings that in recent years great progress has been achieved in the telephone industry and many improvements have been made which should result in longer service life for a great many of the items of property. There seems indeed, to be no way in which prospective service life for the future can safely be estimated through an automatic or mechanical process. The estimate must needs be made by combining the results of actual past experience with the best available engineering advice as to the probabilities of the future."

"Under such circumstances and in view of the great diversity of conditions existing among the various companies, the best that can be done is to require each company, in the first instance, to make an estimate of the prospective service lives of the various classes of property and consequent depreciation percentages for each of its primary accounts of depreciable property in the manner above prescribed, and submit the result, accompanied by a detailed exposition of the facts of record and the engineering advice upon which the estimate has been based. In some instances these percentages will, of course, be composites. In the case of steam railroads we already have an accumulated store of information gathered together in the course of the valuation work which will be of great assistance in passing upon the accuracy of these estimates. To avoid delay in inaugurating the new plan of accounting, it will doubtless be necessary for us, after such estimates and the acompanying expositions have been filed and following an office check, to prescribe percentages of depreciation for each primary account by a temporary order subject to later revision. * * *

"In the case of telephone companies we have already suggested, in an earlier part of this report, a modification of this plan which can be employed with advantage under the unusual circumstances existing. As we there pointed out, the great bulk of telephone business is of strictly local concern, and the State commissions are much better informed and equipped than we are to pass upon the conditions surrounding this local service.

Moreover the interstate commerce act now specifically authorizes us to avail ourselves of the 'cooperation, services, records, and facilities of such state authorities in the enforcement of any provisions of this act.' * * * In the present instance aid, from the State commissions, is not only desirable because of the essentially local character of most of the telephone service, but also because of the substantial relief which it will afford us in the burden of determining prospective service lives and depreciation percentages for the large number of telephone companies operating in this country.

"We are, therefore, of the opinion that in all cases where State commissions have authority intrastate over telephone companies, the prospective service lives and depreciation percentages estimated in the first instance by such companies, with the accompanying expositions of the reasons therefor, should be transmitted to the appropriate State commission or commissions instead of to this commission, and that our temporary order prescribing depreciation percentages should be based upon the recommendations of such commissions. Further proceedings, with a view to modifications of the temporary orders, would be conducted for us by the State commissions. Where more than one State commission has jurisdiction over a particular telephone company, cooperation between such commissions can no doubt be arranged. In the event, also that no State commission has jurisdiction or in the event that such State commission or commissions as have jurisdiction are unwilling to assist us in the manner indicated, it will be necessary to follow the same procedure as in the case of steam railroad companies." (118 I. C. C. 372, 373, 374)

This first short-cut method contemplated that the State commissions, within their respective States, should make studies of data submitted to them by the telephone companies, and should recommend to the Interstate Commerce Commission depreciation rates which that Commission would thereupon promulgate by "temporary orders", which temporary orders would thereafter be corrected as necessity therefor should appear, in hearings thereafter to be

held, either by the State commissions for the Interstate Commerce Commission or by that Commission itself.

This first report was reopened for further consideration. Another report in the same proceeding was made July 28, 1931. The Commission adhered to its plan of enlisting the aid of the State commissions, and of basing temporary depreciation orders upon their recommendations.

An accompanying order was made, already hereinbefore referred to, requiring telephone companies to file estimated depreciation rates with the State commissions not later than September 1, 1932. Depreciation accounting in accordance with the order was to begin on January 1, 1933. (Rec. p. 4.)

This plan for obtaining the help of the State commissions was consistent with the cooperative provisions of Section 13(3) of the Interstate Commerce Act, but the time which the order proposed to allow the State commissions for making their studies and recommendations would have prevented the success of the plan, if it had ever been attempted, as it never was. It gave just four months for the State commissions to begin and conclude their studies, to make their recommendations to the Interstate Commerce Commission, and for that Commission to promulgate orders putting the rates into effect.

By subsequent orders, however, the date before which companies were required to file estimates and data with the State commissions was postponed to August 1, 1934, and the date for beginning depreciation accounting to January 1, 1935. (Rec. 4)

The Second Short-Cut Method Adopted by the Commission, Under Which Action was Taken Which is Relied Upon by the Appellant.

While time was thus running on, the Interstate Commerce Commission changed its plan of procedure in a very important particular. The reason of the change does not appear

from the record, but presumably it was because of the Commission's anxiety to get depreciation accounting into effect, and because it had become evident that it would require years rather than months to procure recommendations from the State commissions, and to make the contemplated temporary orders thereon. Whatever the moving cause, the Commission adopted a new plan, which is that which we have referred to as wholly without warrant of law.

The new plan was this. The Commission was about to issue a Revised Uniform System of Accounts for Class A and B Telephone Companies. It determined to incorporate therein a depreciation order, under which Federal depreciation accounting should begin without awaiting any further order of the Commission.

The Commission promulgated its Revised Uniform System of Accounts accordingly. (Exhibit 7, Rec. 201.)

This required that the telephone utilities, subject to the order, should prepare estimated depreciation rates for their several classes of depreciable property designated by the Commission, and should deliver such estimates to the State commissions accompanied by sworn statements showing the bases therefor, and the methods employed in their computation. Such estimates were to be prepared in the manner directed in Instruction 80, contained in said Uniform System. Instruction 81 of said system provided in part as follows:

> "81. Depreciation charges.—(A) Charges for currently accruing depreciation shall be made monthly to account 608, 'Depreciation,' and account 702, 'Vehicle and other work equipment expense,' as appropriate, and corresponding credits shall be made to account 171, 'Depreciation reserve.' In computing the current monthly charges, one-twelfth of the composite annual percentage rate applicable to the primary accounts covering depreciable telephone plants shall be applied to the average of the balances, as of the first and last of the current month, in each such primary account.
>
> "(C) A separate composite annual percentage rate for each account covering depreciable telephone plant

shall be used in computing depreciation charges. Such composite rates shall be those which are from time to time prescribed by this Commission, *except that where no rates previously have been prescribed for the company's use by this Commission, the company's estimates of composite annual percentage rates computed in accordance with instruction 80 shall be used prior to the date rates prescribe by this Commission become effective.*" (Rec. 212.) (Italics ours)

By this "instruction", contained in the Uniform System of Accounts promulgated November 12, 1932, the Interstate Commerce Commission thus undertook to establish depreciation accounting *not by prescribing depreciation rates, as it was by the statute directed to do, but by ordering the carriers to estimate their own depreciation rates and to use such estimates until the Commission should finally, if ever, prescribe rates found by it to be proper.*

The Interstate Commerce Commission Could Not Delegate Power to the Telephone Companies to Prescribe Their Own Depreciation Rates and Thereby Exempt Such Companies From the Regulation of the State.

Our contention is that this order of the Commission, in so far as it related to depreciation rates, was in no sense a compliance with the statutory mandate, and that it was wholly without warrant of law. In effect, it represented an attempt on the part of the Commission to delegate its own power to the Telephone companies, and to impart to such depreciation rates as the companies might adopt the same character and effect as if they had been prescribed by the Commission.

This was beyond the power of the Commission.

This court has clearly held, in a series of decisions, that the authority of the States may not be displaced under a Federal statute except by procedure in strict conformity with such statute, and the fact of such conformity must clearly appear.

In *Illinois Central Railroad* v. *Public Utilities Commission,* 245 U. S. 492, the court said:

> "In construing Federal statutes enacted under the power conferred by the commerce clause of the Constitution the rule is that it should never be held that Congress intends to supersede or suspend the exercise of the reserved powers of a state, even where that may be done, unless, and except so far as, its purpose to do so is clearly manifested. * * * This being true of an act of Congress, it is obvious that an order of a subordinate agency, such as the Commission, should not be given precedence over a state rate statute otherwise valid, unless and except so far as, it conforms to a high standard of certainty." (245 U. S. 510.)

In *Board of Railroad Commissioners* v. *Great Northern Railway,* 281 U. S. 412, dissolving an injunction which had been granted by the District Court restraining the enforcement of intrastate rates upon the ground that they operated as an undue discrimination against interstate commerce, such discrimination not having been found by the Interstate Commerce Commission, this court said:

> "It is said that the interlocutory injunction, granted below, was in aid of the proceedings pending before the Interstate Commerce Commission. But the injunction necessarily has the effect of preventing the state from enforcing the rates it has prescribed, which are lawful rates until the Interstate Commerce Commission finds that they cause an unjust discrimination against interstate commerce. A judicial restraint of the enforcement of intrastate rates, although limited to the pendency of proceedings before the Interstate Commerce Commission, is none the less essentially a restraint upon the power of the state to establish rates for its internal commerce, a power the exercise of which in prescribing rates otherwise valid is not subject to interference upon the sole ground of injury to interstate commerce, save as Congress has validly provided. Congress has so provided only in the event that, after full hearing in which the state authorities may partici-

pate, the Interstate Commerce Commission finds that unjust discrimination is created." (281 U. S. 430)

The Contention Now Presented by the Appellant Was Overruled in the Illinois Bell Telephone Case.

In *Smith* v. *Illinois Bell Telephone Company,* 282 U. S. 133, exactly the same argument was made as is presented here by the appellant. This court in that case said:

> "The company urges that, as Congress has granted jurisdiction to the Interstate Commerce Commission over the depreciation rates of telephone companies doing an interstate business (Interstate Commerce Act, Sec. 20(5), as amended by Transportation Act, February 28, 1920, U. S. C. title 49, Sec. 20) this subject is now completely withdrawn from the power of the state. It is said that two rates of depreciation cannot be charged on the same property. The Interstate Commerce Commission has had the matter under consideration (Re Telephone & R. Depreciation Charges, 118 Inters. Com. Rep. 328-333) but so far as we are advised a final determination has not yet been made. The Interstate Commerce Commission has its accounting rules with reference to depreciation charges and, pending its order under Sec. 20(5) of the Interstate Commerce Act, telephone companies, as well as others subject to the act, have been directed to continue to observe these requirements. The company argues that, although the Interstate Commerce Commission has not finally ruled, the action taken by Congress excludes the jurisdiction of state tribunals under familiar principles. *Northern P. R. Co.* v. *Washington,* 222 U. S. 370, 378, 56 L. ed. 237, 239, 32 S. Ct. 160; *Pennsylvania R. Co.* v. *Public Service Commission,* 250 U. S. 566, 569, 63 L. ed. 1142, 1145, P. U. R. 1920A, 909, 40 S. Ct. 36; *Oregon-Washington R. & Nav. Co.* v. *Washington,* 270 U. S. 87, 102, 70 L. ed. 482, 488, 46 S. Ct. 279. We are unable to assent to this view. As the Interstate Commerce Commission has not acted finally in the matter, we are not now called upon to consider the scope of its authority in relation to depreciation charges, but we are of the opinion that, in any event until action has been taken which

could be deemed validly to affect the amount to be charged to depreciation in connection with intrastate business so as to affect intrastate rates, the prerogative of the state to prescribe such rates, and the jurisdiction and duty of the statutory court in considering their validity to determine the amount properly allowable for depreciation in connection with the intrastate business, are not to be gainsaid. Compare *Railroad Comrs.* v. *Great Northern R. Co.*, 281 U. S. 412, 74 L. ed. 936, 50 S. Ct. 391." (282 U. S. 133, 159)

No order prescribing depreciation rates has yet been made either by the Interstate Commerce Commission or by the Federal Communications Commission, and hence the court is not called upon to consider the scope of its authority when the Commission shall have acted. Pending such action the States are not disabled to make such requirements for State accounting as they may deem in the public interest. *Missouri Pacific Railway Co.* v. *Larabee Flour Mills Co.*, 211 U. S. 612, 623. In the cited case the court held that the mere grant by Congress to the Commission of certain national powers in respect to interstate commerce, does not of itself, and in the absence of action by the Commission, interfere with the authority of the State to make these regulations conducive to the welfare and convenience of its citizens.

The Requirement of the Order That the Plaintiff Should Keep Accounts Showing Depreciation at the Prescribed Rate Upon All of Its Depreciable Property in Nebraska Did Not Exceed the Jurisdiction of the Nebraska Commission.

The plaintiff lays stress upon the requirement of the order that the prescribed composite depreciation rate should be applied for all the plaintiff's depreciable property in Nebraska. This, however, is no ground of invalidity.

The order looks merely towards placing upon the books of the plaintiff certain information which shall be available to the defendant Commission, to the tax officials, and other

officials of the State and to the public. It places no obligation upon the plaintiff with respect to the use of the property covered, and is in no sense a regulation of such use. The reverse of this question was before this court in *Interstate Commerce Commission* v. *Goodrich Transit Company*, 224 U. S. 194. That case involved the right of the Interstate Commerce Commission to require the keeping of accounts concerning purely intrastate business. The Commission's order was sustained. The court said:

> "If the Commission is to successfully perform its duties in respect to reasonable rates, undue discriminations and favoritism, it must be informed as to the business of the carriers by a system of accounting which will not permit the possible concealment of forbidden practices in accounts which it is not permitted to see and concerning which it can require no information. It is a mistake to suppose that the requiring of information concerning the business methods of such corporations, as shown in their accounts, is a regulation of business not within the jurisdiction of the Commission, as seems to be argued for the complainants. The object of requiring such accounts to be kept in a uniform way and to be open to the inspection of the Commission is not to enable it to regulate the affairs of the corporations not within its jurisdiction, but to be informed concerning the business methods of the corporations subject to the act that it may properly regulate such matters as are really within its jurisdiction. Further, the requiring of information concerning a business is not regulation of that business." (224 U. S. 194, 211)

This case established the right of the Federal Commission to impose accounting requirements with respect to property, the operation of which it had no power to regulate. In the same way, the Nebraska Commission having been vested with jurisdiction over the intrastate business of the appellant, has a right to demand information concerning the expense of operation of all its business in Nebraska, both interstate and intrastate.

The Appellant Apparently Recognizes that no Valid Action was Taken Under the Grant of Power of the Interstate Commerce Commission to Prescribe Depreciation Charges.

In appellant's brief at page 39, it is said:

> "It is not the nature of the subject matter or facts that are to be recorded upon the books which is characteristic of the exercise of federal authority. Jurisdiction of accounting does not here depend upon jurisdiction to regulate the transactions which are being accounted for. Hence it is that the argument here made does not look for any essential foundation to the amendment of Section 20, Paragraph (5) of the Interstate Commerce Act by the Transportation Act of 1920, which directed the Interstate Commerce Commission to determine the classes of property for which depreciation should be charged as an expense, and to fix the rates of depreciation to be charged with respect to each class.

The appellant thus apparently recognizes that the Interstate Commerce Commission has not taken valid action under the power to prescribe depreciation rates, which was vested in it in 1920, and therefore attempts to treat the power to prescribe *the rate* of depreciation as a part of the power to prescribe *the form* of depreciation. The two things, however, are quite distinct.

The extent of depreciation is of course a fact which can not be altered by any record which is made concerning it. It is a fact which can not be known otherwise than by estimate. Therefore depreciation accounting is nothing more nor less than the recording of estimated depreciation.

The making of estimates of depreciation is not accounting. It is something very different. It is the exercise of judgment. While it involves computation, such computation is based upon estimates of the service life and salvage value of any property to be depreciated, made in the light of conditions by which the property is affected, and of all

available engineering and other information with respect to prospective future conditions.

A system of accounting rules will direct the recording of depreciation after the estimate of the amount of it has been made, but it is not possible to devise an accounting rule which will determine the amount to be thus recorded.

The Bell Companies agree to the truth of this statement, as appears from the report of the Interstate Commerce Commission in *Depreciation Charges for Telephone Companies,* 118 I. C. C. 295, hereinbefore cited, to which they were parties. It is there said:

> "Upon one proposition all parties are agreed, and that is that the service lives of the same kind of property vary widely in different companies. It is impossible to lay down any general rule which will apply in the case of all companies or even in the case of a particular class of companies, owing to the different conditions which surround the use of the property in each individual case. * * * There seems, indeed, to be no way in which prospective service life for the future can safely be estimated through an automatic or mechanical process. The estimate must needs be made by combining the results of actual past experience with the best available engineering advice as to the probabilities of the future." (118 I. C. C. 295, 372, 373)

In the face of this situation, it is obvious that no method of accounting procedure can be prescribed which will determine what should be written into the accounts to cover depreciation without the intervention at some stage of some person or persons exercising judgment.

From this it necessarily follows that Section 20(5) of the Interstate Commerce Act, conferred upon the Interstate Commerce Commission two distinct powers, with respect to telephone companies. One was the power to prescribe *forms of accounts,* and the other was the power to determine *what classes* of property should be considered subject to depreciation and *what percentage rates* should be used

to determine the amounts to be written into the prescribed accounts as representing depreciation upon each class of depreciable property.

Instruction 80, relied upon by the appellant, does not purport either to prescribe depreciation rates or the use of designated factors, and the manner of their use, whereby such depreciation rates might be computed.

Instruction 80 leaves each utility free to estimate service values and service lives for itself, and these estimates determine the depreciation rates to be arrived at.

It results, therefore, that the full effect of the Uniform System of Accounts now in force, in so far as depreciation is concerned, is to provide for the recording of depreciation charges when determined, but not for the determination of them.

There is No Conflict Between the Nebraska Order and the System of Accounts Prescribed by the Interstate Commerce Commission.

Inasmuch as said Section 20(5) of the Interstate Commerce Act directs that depreciation charges for Federal depreciation accounting shall be prescribed by the Interstate Commerce Commission, any language contained in said Instruction 80 which attempts to delegate to the telephone companies the power to determine such charges as they will use for depreciation accounting is ineffective and mere surplusage.

Were it to be assumed, however, that the order which is contained in the prescribed System of Accounts is valid to the extent of determining the classes of depreciable property, the Nebraska order does not in any way conflict therewith, for the Nebraska Commission in said order has prescribed the same classes of depreciable property as the Interstate Commerce Commission has prescribed. (Rec. 20 and 213.)

The Nebraska order leaves the appellant entirely free

to keep its accounts as prescribed by the Interstate Commerce Commission. Seemingly the Interstate Commerce Commission's system is in effect for State purposes, for the Nebraska order indicates depreciable property by the same accounting numbers as does the Uniform System of Accounts. (Rec. 20 and 213.)

The only requirement of the Nebraska order complained of as conflicting is the requirement that, for State accounting and reporting purposes, the amount of depreciation shall be taken to be 3½ per cent of the investment in depreciable property located in Nebraska.

It is true that said Instruction 80 directs the preparation by the appellant of an estimated composite depreciation rate for each of the several classes of its depreciable property, and it is true that said Instruction 81 undertakes to make that estimated depreciation rate the depreciation rate to be observed in computing the amounts to be written into the appellant's accounts; but this attempt to delegate power to the appellant and other telephone utilities being ineffective, as without warrant of law, there are no prescribed rates of depreciation for the several classes of depreciable property which can produce a composite depreciation rate for all of such property. Hence there is no composite rate for all of such property with which the 3½ per cent rate prescribed by the Nebraska Commission can be in conflict.

The order of the Nebraska Commission was legislative in character, and in the absence of requirement therefor in the Nebraska law, no hearing was necessary preliminary to the making of the same.

In the instant case, a hearing was held pursuant to a notice given to the appellant, and the appellant appeared and was fully heard. The requirements of due process of law, if such requirements call for a hearing before the Commission and for due notice thereof, were fully complied with. We submit, however, that a hearing is not a necessary pre-

liminary to the prescribing of accounting regulations, by a regulatory body vested with the power to prescribe such regulations, unless the grant of power has been limited by a provision that it must be exercised only after a hearing.

All of the Federal regulatory commissions are empowered to prescribe accounting regulations without any provision for hearing.* In none of these cases is there any require-

*The essential portions of the various statutes are as follows:

The Interstate Commerce Act.

"Sec. 20(5). The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys. The Commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. * * * "

The Communications Act of 1934.

"Sec. 220(a) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.

"(b) The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. * * *"

Public Utility Holding Company Act.

"Sec. 15(a). Every registered holding company and every subsidiary company thereof shall make, keep, and preserve for such periods, such accounts, cost-accounting procedures, correspondence, memoranda, papers, books, and other records as the Commission deems necessary or appropriate in the public interest or for the protection of investors or consumers or for the enforcement of the provisions of this title or the rules, regulations, or orders thereunder.

"(e) After the Commission has prescribed the form and manner of making and keeping accounts, cost-accounting procedures, correspondence, memoranda, papers, books, and other records to be kept by any person hereunder, it shall be unlawful for any such person to keep any accounts, cost-accounting procedures, correspondence, memoranda, papers, books, or other records other than those prescribed or such as may be approved by the Commission, or to keep his or its accounts, cost-accounting procedures, correspondence, memoranda, papers, books, or other records in any manner other than that prescribed or approved by the Commission.

"Sec. 20 (b). In the case of the accounts of any company whose methods of accounting are prescribed under the provisions of any law of the United States or of any State, the rules and regulations or orders of the Commission in respect of accounts shall not be inconsistent with the requirements imposed by such law or any rule or regulation thereunder; nor shall anything in this title relieve any public-utility company from the duty to keep the accounts, books, records, or memoranda which may be required to be kept by the law of any State in which it operates or by the State commission of any such State. But

ment for hearing before the Commission shall prescribe its accounting regulations. In each of the acts, however, careful provision is made for hearing when it is intended that the Commission shall act judicially.

The Interstate Commerce Commission has not acted judicially in prescribing accounting regulations. Its practice was stated by the Commission in its preliminary report in No. 14,700, dated August 15, 1929, as follows:

> "It should be noted that our function in prescribing accounting rules and regulations, including those governing the accounting for depreciation, is administrative. It may be, and in the past has been, performed without the aid of public hearings, and in securing the information necessary to its performance we are not confined to the limits of a formal record."

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this provision shall not prevent the Commission from imposing such additional requirements regarding reports or accounts as it may deem necessary or appropriate in the public inteest or for the protection of investors or consumers."

The Federal Power Act.

"Section 301(a) Every licensee and public utility shall make, keep, and preserve for such periods, such accounts, records of cost-accounting procedures, correspondence, memoranda, papers, books, and other records as the Commission may by rules and regulations prescribe as necessary or appropriate for purposes of the administration of this Act, including accounts, records, and memoranda of the generation, transmission, distribution, delivery, or sale of electric energy, the furnishing of services or facilities in connection therewith, and receipts and expenditures with respect to any of the foregoing: *Provided, however*, That nothing in this Act shall relieve any public utility from keeping any accounts, memoranda, or records which such public utility may be required to keep by or under authority of the laws of any State. The Commission may prescribe a system of accounts to be kept by licensees and public utilities and may classify such licensees and public utilities and prescribe a system of accounts for each class. The Commission, after notice and opportunity for hearing, may determine by order the accounts in which particular outlays and receipts shall be entered, charged, or credited. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making authorizing, or requiring such entry, and the Commission may suspend a charge or credit pending submission of satisfactory proof in support thereof.

"Sec. 302(a) The Commission may, after hearing, require licensees and public utilities to carry a proper and adequate depreciation account in accordance with such rules, regulations, and forms of account as the Commission may prescribe. The Commission may from time to time, ascertain and determine, and by order fix, the proper and adequate rates of depreciation of the several classes of property of each licensee and public utility. Each licensee and public utility shall conform its depreciation accounts to the rates so ascertained, determined and fixed. * * *"

In *Accounting Rules for Telephone Companies,* No. 25705, 203 I. C. C. 13, the manner in which the Commission proceeded in the adoption of the Uniform System of Accounts for Telephone Companies, which is involved in this case, appears. The Commission held no hearings before prescribing the system. After the same was prescribed, various State commissions having asked for changes therein, the Commission set the matter down for a so-called hearing, but such hearing was confined to argumentative statements, without sworn testimony.

It appears that the question as to whether the Commission had proceeded properly, in promulgating a system of accounts for railroads, was raised in *Kansas City Southern Railroad* v. *United States,* 231 U. S. 423, and counsel for the Commission and for the United States met the issue squarely. Counsel for the Commission in his brief said:

> "In prescribing the classification of accounts, bookkeeping, and an annual balance sheet, the Commission was acting in purely a legislative capacity. The act did not require that any hearing be given to the carriers. Like Congress, the Commission was to inform itself upon the subject, and, in pursuance of the general instructions of Congress, contained in the act, was authorized to prescribe a uniform classification and system of accounts for all interstate carriers. The Commission was to fill in the details, and this involved a classification of the items going into the accounts. The proceedings by the Commission fall within the general category of administrative functions."

The Government brief, filed by the Assistant Attorney General, stated the Government's position as follows:

> "In dealing with such a question it is important to keep in mind that the function of the Commission in this class of matters is not even quasi judicial, but exclusively administrative, and so open to no review in any matter of opinion."

In that case the order of the Commission was sustained in both the United States District Court and in this Court. The District Court said:

> "The orders were made pursuant to a command of the statute. The Commission could have made them without consulting anyone, and the fact that the Commission received such letters as were offered in evidence was immaterial. * * *" (204 Fed. Rep. 641, 646.)

In the *Norfolk and Western Railroad* case, 287 U. S. 134, the Commission's order, which this court sustained, undeniably required the company to carry upon its books as non-carrier property certain coal mines which were purchased for, and actually devoted to, carrier uses. The Court said:

> "With great earnestness the appellant characterizes the order as in several aspects a denial of due process. It declares that by virtue of the Commission's mandate an unfair and improper rate base is fixed, and a capital asset properly to be taken into account for purposes of recapture is eliminated. But this is to ignore the fact that the order is one touching accounting merely; that before any rate base can be ascertained or any basis of recapture determined the carrier will be entitled to a full hearing as to what property shall be included; and not until the Commission excludes the assets in question from the calculation may the carrier assert the infliction of injury to its rights of property." (287 U. S. 134, 141.)

In *State Corporation Commission* v. *Wichita Gas Company*, 290 U. S. 561, the State commission had ordered subsidiaries of a holding company to cease setting up on their books of account as operating expense items, payments of 1¼ per cent of their gross earning to a holding company for managerial services. That the services were performed, and were of some value, seemingly was not open to ques-

tion, but this Court sustained the order of the Commission, saying in part:

> "We need not decide whether these provisions are repugnant to the Constitution or whether they are otherwise invalid. The invalidity of such an order is not of itself ground for injunction. Unless necessary to protect rights against injuries otherwise irremediable, injunction should not be granted. * * * Appellees in substance suggest that, unless now adjudged invalid and enjoined, the findings and directions of the commission in respect of their operating expenses and the fixing of rates will be binding upon them in later proceedings for the prescribing of rates to be charged by them for gas furnished to consumers and in suits involving the validity of such rates. But the commission's proceedings are to be regarded as having been taken to secure information later to be used for the ascertainment of reasonableness of rates. The order is therefore legislative in character. The commission's decisions upon the matters covered by it cannot be res adjudicata when challenged in a confiscation case or other suit involving their validity or the validity of any rate depending upon them. * * * And upon the issue of confiscation vel non they are entitled to the independent judgment of the courts as to both law and facts. * * * It results, therefore, that * * * the challenged provisions are merely preliminary steps in aid of investigations for the ascertainment of the reasonableness of appellees' rates, and they have no binding force in respect of payment to the pipe line company or rates to be charged consumers and cannot be res adjudicata. The decree in so far as it enjoins enforcement of the provisions of that order will be vacated." (290 U. S. 561, 568, 569, 570)

If the order involved in this case was within the jurisdiction of the Nebraska Commission, the accuracy of the depreciation rate prescribed thereby is not open to review in this proceeding. If at any time the accounts and reports which the appellant is required to keep or to make shall be made use of for the purpose of fixing its rates, or otherwise

in such manner as to affect its property rights, the appellant will then be entitled to resort to the courts for the vindication of any right which may be disregarded. Pending such action, however, it has no legal ground of complaint.

CONCLUSION.

The judgment of the Supreme Court of Nebraska should be affirmed.

Respectfully submitted,

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EDWIN VAIL,
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SUPREME COURT OF THE UNITED STATES.

No. 350.—October Term, 1935.

Northwestern Bell Telephone Company, Appellant, *vs.* Nebraska State Railway Commission.	Appeal from the Supreme Court of the State of Nebraska.

[March 2, 1936.]

Mr. Justice Stone delivered the opinion of the Court.

This case comes here on appeal under § 237 of the Judicial Code from a judgment of the Supreme Court of Nebraska, 128 Neb. 447, affirming an order of the Nebraska State Railway Commission which directs appellant Telephone Company to use, for purposes of accounting and reporting to the Commission, for the year 1934, a composite depreciation rate of 3½% upon all its depreciable property in Nebraska.

Appellant now assails the order on three grounds: (1) that it was made without such notice and hearing as due process requires; (2) that it is invalid because the Interstate Commerce Commission, pursuant to Congressional legislation, has occupied the field of regulation of telephone company accounting, and has made valid orders conflicting with that of the State Commission; and (3) that it infringes due process because it is unsupported by evidence and deprives appellant of the right to keep accurate books of account.

The record does not disclose what, if any, federal questions were presented to the state supreme court. Its opinion discusses only the first two contentions made here, and we accordingly confine our review to them. See *Miedreich* v. *Lauenstein*, 232 U. S. 236; *Cissna* v. *Tennessee*, 246 U. S. 289; *Saltonstall* v. *Saltonstall*, 276 U. S. 260.

1. Assuming, without deciding, that due process requires that the Commission's order be upon notice to appellant and opportunity to be heard, we think that requirement was satisfied by the procedure followed by the Commission. The challenged order was made at the conclusion of proceedings initiated by the State Commission by its General Order No. 59, directing Class A telephone companies, to which class appellant belongs, to file with the Com-

mission specified schedules of depreciation rates. The order was prefaced by an opinion of the Commission.

The opinion, after reciting the authority conferred upon the Interstate Commerce Commission by § 20 of the Interstate Commerce Act, as amended by the Transportation Act of 1920, 41 Stat. 493, to fix and prescribe depreciation charges for telephone companies, refers to the order of that Commission of July 28, 1931, In Depreciation Charges for Telephone Companies, Docket No. 14,700, 177 I. C. C. 351, which, for the assistance of the Commission in prescribing depreciation charges, required Class A telephone companies to file with their respective state commissions by September 1, 1932, their estimates of composite annual percentage depreciation rates applicable to each class of depreciable property owned or used by them, with supporting data. The order provided for the adoption of a depreciation rate by the Commission, to be effective January 1, 1933. The opinion of the State Commission points out that by later order of the Interstate Commerce Commission the filing date was postponed to August 1, 1934, and the date for the prescribed rate to January 1, 1935.

The opinion also refers to the Depreciation Section Service Circular 7, issued by the Interstate Commerce Commission Bureau of Accounts, which requested that schedules of depreciation rates and statements of estimated service lives and salvage values of telephone property be submitted not later than March 1, 1934, "in order that the Commission may be informed as to the rates contemplated for use" by the telephone companies for the year 1934. The opinion states that it is the view of the State Commission that it has not been deprived of jurisdiction to fix rates for intrastate telephone service, and that, while Congress has given the Interstate Commerce Commission authority to prescribe a uniform system of accounting and rates of depreciation for purposes of accounting to it, the state commissions are not deprived of their authority to fix rates of depreciation so far as their own accounting and reporting system is concerned.

The Commission accordingly ordered that Class A telephone companies file with it, not later than March 1, 1934, a schedule of depreciation rates by primary accounts which they proposed to apply for the calendar year 1934, with such supporting data as is required by the Interstate Commerce Commission, and to

file not later than August 1, 1934, their composite annual percentage depreciation rates to be effective January 1, 1935, in accordance with the order of the Interstate Commerce Commission in Docket No. 14,700, and its supplemental orders. The order of the State Commission concludes with the statement that it approves the procedure adopted by the Interstate Commerce Commission for prescribing depreciation rates, except that "It reserves the right to review the findings and conclusions of the Interstate Commerce Commission and enter a final order thereon as to the depreciation rate for accounting purposes to this commission."

In compliance with this order appellant, on March 1, 1934, filed schedules classifying its depreciable property in twelve accounts, with estimated rates of depreciation of each class for 1934, and showing a composite estimated rate of depreciation on all accounts of 4.48%.

Upon examination of these schedules the Commission made a further order, on March 6, 1934, reciting that depreciation rates for 1934 had been filed and that it was not "fully satisfied with the rates proposed", and directing that the case be set "for hearing for oral examination of the members of respondent's staff, who had prepared said schedules, and for the introduction of such evidence as the Commission may desire to submit with opportunity of objections and cross-examination by respondent."

Appellant argues that throughout these proceedings it was not advised that the Commission proposed to make any order with respect to depreciation rates for 1934, or to do more than make recommendations as to the proper depreciation rates to be adopted by the Interstate Commerce Commission for 1935. But it was evident from the opinion and orders of the Commission mentioned that it proposed to deal with two aspects of appellant's depreciation accounting. One was the gathering of data with respect to the proposed rates of depreciation for 1935, which the order of the Interstate Commerce Commission had directed should be filed with the state commissions, and as to which the latter had been requested to submit their recommendations. The other related to the State Commission's asserted authority to fix depreciation rates, its rejection of the proposed rates for 1934 as unsatisfactory, and its direction that hearings be had on them. That the primary purpose of the hearing was to aid the Commission in its

rate-making rather than its advisory function seems apparent, the more so as the order for the hearing refers only to the 1934 rates and as the date set for it was in March, four months before August 1, 1934, the date fixed for filing data for the 1935 rate, with respect to which alone the Commission had been asked to exercise its advisory function. Because of subsequent postponements the date for submitting the data for 1935 never arrived.

Possibility of doubt as to the purpose of the hearing was removed in its course before the Commission. At the outset the presiding commissioner announced that the purpose was to fix the 1934 rate, a statement which he repeated later in the course of the hearing on the same day. To this appellant made no objection. The hearing occupied two days. Appellant was represented by counsel. It produced witnesses, including its own engineer and others who had prepared the filed depreciation schedules for 1934, who were examined and cross-examined at length. No evidence tendered by it was rejected. So much of the testimony as is included in the bill of exceptions occupies 151 pages of the printed record. It discloses that both the Commission and the appellant were seeking to establish the proper rate of depreciation to be applied to appellant's property for 1934. The state court rightly concluded that appellant was afforded a full hearing upon adequate notice that the Commission proposed to fix a depreciation rate for 1934, and that the requirements of due process were satisfied.

2. The remaining question is whether the jurisdiction conferred by Congress upon the Interstate Commerce Commission over accounts and depreciation rates of telephone companies, and the exercise of that jurisdiction by the Commission, have operated to curtail state authority over depreciation rates for 1934.

The Interstate Commerce Commission was given no jurisdiction over telephone service rates, but §§ 1 (1), 20 (1) (5) of the Interstate Commerce Act, as amended by Act of June 29, 1906, 34 Stat. 595, see 36 Stat. 555, 556, conferred on the Commission authority, in its discretion, to prescribe a uniform system of accounts for telephone companies, and made it unlawful for them to keep any other accounts than those prescribed or approved by the Commission. Such a system of accounts was required by the Commission February 1, 1913. Effective January 1, 1933, it prescribed

a Revised System of Accounts for Class A and Class B Telephone Companies and directed that they keep all accounts in conformity to it.

The Commission never undertook to prescribe rates of depreciation for telephone companies under the Act of 1906. But the Transportation Act of February 28, 1920, again amending § 20 (5) of the Interstate Commerce Act, directed the Commission, "as soon as practicable", to prescribe the classes of property of carriers, including telephone companies, "for which depreciation charges may properly be included under operating expenses and the percentages of depreciation which shall be charged with respect to each of such classes of property." Carriers were forbidden to charge depreciation rates other than those prescribed by the Commission. Since 1920 the Interstate Commerce Commission has taken steps preparatory to the establishment of rates of depreciation for telephone companies, some of which we have mentioned. The adoption of rates has been postponed from time to time and has now been indefinitely postponed by Order of the Communications Commission of May 1, 1935, to which the authority of the Interstate Commerce Commission over telephone companies was transferred by Act of Congress of June 19, 1934, 48 Stat. 1064.

We leave aside the argument of respondent that the federal government is powerless to deny to the states authority to prescribe accounts and depreciation rates to assist them in fixing rates for intrastate telephone service, see *Interstate Commerce Commission* v. *Goodrich Transit Co.*, 224 U. S. 194; compare *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, 586; *Collector* v. *Day*, 11 Wall. 113, 124; *Ambrosini* v. *United States*, 187 U. S. 1, 7, and pass to the question, decisive of the present case, whether there has yet been any exercise of such power. Both the language of the statute already quoted, and the nature of its subject matter indicate that it contemplated no restriction of state control over depreciation rates until the Interstate Commerce Commission had prescribed its own rates. State commissions were not deprived of power to fix rates for intrastate telephone service, in determining which rates of depreciation chargeable to operating expenses play an important part. See *Lindheimer* v. *Illinois Bell Telephone Co.*, 292 U. S. 151. The statute did not envisage an immediate adoption of depreciation rates by the Interstate Commerce Commission. A

long period might elapse, as the event has shown, before the Commission would be prepared to act. It cannot be supposed that Congress intended by the amendment to § 20 (5) to preclude all regulation, state and national, of depreciation rates for telephone companies, for an indefinite time, until the Interstate Commerce Commission could act administratively to prescribe rates. See *Illinois Central R. Co.* v. *Public Utilities Commission*, 245 U. S. 493, 510; *Railroad Commissioners* v. *Great Northern R. Co.*, 281 U. S. 412, 430. In *Smith* v. *Illinois Bell Tel. Co.*, 282 U. S. 133, 139, this Court pointed out that until the Interstate Commerce Commission has prescribed depreciation rates the prerogative of the state to regulate such rates cannot be gainsaid. See also *Missouri Pacific R. Co.* v. *Larabee Flour Mills Co.*, 211 U. S. 612, 623.

When respondent fixed the composite rate of depreciation applicable to all classes of appellant's property for 1934, the Interstate Commerce Commission had prescribed no rate. It had given directions for filing data with state commissions preparatory to establishing a rate for the year 1935, and by the Revised Uniform System of Accounts for Telephone Companies, effective in 1933, it had prescribed (Instruction 81 (A) (C)) the method by which depreciation accounts should be kept, directing that there be a composite annual percentage rate of depreciation for each account covering depreciable property, and that until rates "prescribed by this Commission become effective" the company's estimated composite rate be used.

It is said that the company rate, use of which was thus authorized for accounting purposes, must be taken as the prescribed rate until the Commission has fixed its own rate, and that in consequence state commissions are powerless to disturb it. But the order shows on its face that the Commission did not regard the company rates as rates prescribed by the Commission as required by § 20 (5) and we think the purpose of the order, made plain by its language, was to establish a method of accounting, not to prescribe depreciation rates within the meaning of § 20 (5). It thus, without purporting to restrict the power of state commissions over depreciation rates, left the telephone companies free, so far as the Interstate Commerce Commission was concerned, to use their own depreciation rates for purposes of the required accounting, until the Commission performed the duty to establish rates, imposed upon it by Congress.

In any event, we think that § 20 (5) cannot be read as authorizing the Interstate Commerce Commission to supplant state power to regulate depreciation rates of telephone companies except by prescribing a rate administratively determined by the Commission itself. A direction that the Commission, as soon as practicable, prescribe depreciation rates, is hardly to be read as authority to permit the telephone companies to fix the rates for themselves in defiance of state power. The doubtful constitutionality of the statute if so construed precludes our acceptance of such a construction.

The Commission has thus prescribed no depreciation rates as required by § 20 (5). No exertion of federal authority, through the Interstate Commerce Act, § 20 (5), (6), (7), the orders of the Commission, or otherwise, forbids the making of entries in appellant's accounts or the doing of anything that is by the state commission's order directed to be done. Pending action by the Communications Commission establishing depreciation rates for telephone companies, state control over such rates remains unimpaired. We are not called upon now to consider the effect upon state power of such rates when adopted, or, in view of the state of the record, to consider other objections to the order of the State Commission fixing for appellant a composite depreciation rate of 3½%.

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.